Supreme Court, U.S.
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NO. 89-935

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

VS.

VALERO TRANSMISSION COMPANY,
Appellee

FROM NO. 04-87-00380-CV
IN THE COURT OF APPEALS FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS
AT SAN ANTONIO, BEXAR COUNTY, TEXAS

APPENDIX TO MOTION TO DISMISS APPEAL AND, ALTERNATIVELY, TO AFFIRM JUDGMENT

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APPEAL NO. 04-87-00380-CV

IN THE
Court of Appeals
FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS
SAN ANTONIO, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants,

v.

VALERO TRANSMISSION COMPANY,
Appellee.

Appeal from the District Court of Sutton County, Texas, 112th Judicial District

BRIEF FOR APPELLANTS

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COMPLETE LIST OF THE PARTIES

Pursuant to Rule 74(a) of the Texas Rules of Appellate Procedure, a complete list of the names of all parties follows:

Appellants: Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters and Theodore L. Wilkinson.

Appellee: Valero Transmission Company.

APPEAL NO. 04-87-00380-CV

IN THE

Court of Appeals

FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF TEXAS
SAN ANTONIO, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants,

v.

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Appellee.

**Appeal from the District Court of
Sutton County, Texas, 112th Judicial District**

BRIEF FOR APPELLANTS

To The Court Of Appeals:

Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley, Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H. B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters and Theodore L. Wilkinson (collectively referred to as "Lively" or "Appellants") file this Brief for Appellants with the Court of Appeals.

PRELIMINARY STATEMENT

This is an appeal of part of a final judgment following a jury trial (Tr. 188). The judgment arose from a suit filed by Lively against Valero Transmission Company ("Valero") for breach of a gas purchase contract (Tr. 3, 35). Lively alleged that Valero breached its obligations under the contract by failing to take delivery of and pay for the Daily Contract Quantity of natural gas during certain contract years or pay for such Daily Contract Quantity of natural gas, whether taken or not (Tr. 37), and by instituting a unilateral rollback of the price paid for gas actually taken under the contract (Tr. 38). The judgment ordered that Lively take nothing on their claim for breach of the take-or-pay provision of the contract, awarded Lively $1,204,778.60 on the pricing claim, and awarded Lively $500,000.00 for attorneys' fees.

Appellants seek a reversal of that part of the Trial Court's judgment ordering that they take nothing on their claim for breach of the take-or-pay provision of the gas purchase contract and an affirmance of the remainder of the judgment.

POINTS OF ERROR

POINT OF ERROR ONE: The Trial Court erred in admitting evidence of the Railroad Commission's gas market demand rule offered by Valero in support of its contention that such rule relieved Valero of its take-or-pay obligations under the contract, because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas (S.F. 1680-1681).

POINT OF ERROR TWO: The Trial Court erred in including the gas market demand rule in Instruction 2 to Special Issue 2, because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas (S.F. 1680-1682; Tr. 145-146).

POINT OF ERROR THREE: The Trial Court erred in the definition of the term "deliverability" used in Instruction 2 to Special Issue 2 (S.F. 1675; Tr. 145).

POINT OF ERROR FOUR: The Trial Court erred in failing to define the term "deliverability" as it is used in the take-or-pay provision of the gas purchase contract (S.F. 1676-1682; Tr. 145).

POINT OF ERROR FIVE: The Trial Court's instructions to Special Issue 2 were prejudicial comments on the weight of the evidence (Tr. 145-146).

POINT OF ERROR SIX: The Trial Court erred in conditionally submitting Special Issue 3 (S.F. 1682; Tr. 147).

POINT OF ERROR SEVEN: The Trial Court erred in entering judgment for Valero on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because, as a matter of law, there was no evidence to support the finding.

POINT OF ERROR EIGHT: The Trial Court erred in entering judgment on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because the only evidence in support of that finding is legally incorrect and is factually insufficient to support the finding.

POINT OF ERROR NINE: The Trial Court erred in entering judgment on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because the finding was against the great weight and preponderance of the credible evidence, which conclusively showed that Valero failed to take or pay for the Daily Contract Quantity of gas.

STATEMENT OF FACTS

On or about February 12, 1973, Lively Exploration Company, on behalf of itself and all other Appellants named herein, entered into a Gas Purchase Contract (the "Contract") with Lo-Vaca Gathering Company ("Lo-Vaca") for the sale of natural gas produced from certain properties of Appellants in Sutton County, Texas ("the Contract Area") (P. Ex. 1; S.F. 115). Appellee, Valero, is the successor in interest to Lo-Vaca under the Contract (S.F. 57-58, 111).

The Contract grants Valero the exclusive right for 20 years to purchase all gas from the Contract Area.

Valero has the continuing right and obligation to purchase, upon the terms and conditions and at the prices specified in the Contract, all gas owned or controlled by Appellants from the Contract Area during the term of the Contract.

The Contract provides that Valero will, for each Contract Year, either (1) take delivery of and pay for the Daily Contract Quantity of natural gas or (2) pay for the Daily Contract Quantity of natural gas, whether taken or not. The Daily Contract Quantity is defined as a quantity of gas equal to ninety percent (90%) of Lively's daily deliverability of gas averaged over the Contract Year. The quantity of gas to be purchased by Valero each Contract Year is determined by multiplying the Daily Contract Quantity by the number of days during the Contract Year during which Valero's performance was not excused by the Contract.

Article V, ¶ 5.3, of the Contract provides, *inter alia*, as follows:

> Subject to the other provisions hereof, Buyer agrees to purchase and pay for (*or*, if Buyer's performance hereunder is not excused by other provisions of this Agreement, *pay for, if available, whether taken or not*) during the days of each contract year of the term hereof a Daily Contract Quantity of gas from Sellers' Lands and Leases in the Contract Area equal to ninety percent (90%) of Sellers' daily Deliverability of gas hereunder. Upon request by Buyer or Seller, *Sellers' Deliverability shall be determined and established by Buyer by testing the actual ability of Sellers' wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90)

> day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points delivery at the time of the test. . . .[1]

This provision in the Contract is commonly known in the oil and gas industry as a "take or pay" clause. Take-or-pay provisions in various forms have been standard provisions in gas purchase contracts since the early 1950's.

The Contract also contains a definition of the term "deliverability" which differs from the manner in which that term is used in the take-or-pay provision quoted above. Article I (j) of the Contract defines the term "deliverability" as:

> [T]hat quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas production practice can be produced from Seller's wells in the fields.

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[1] Emphasis added throughout except where indicated otherwise.

Beginning with the 1982 Contract Year (June 1, 1982 - May 31, 1983), and continuing through the 1985 Contract Year, Valero failed to either take and pay or simply pay for the minimum quantity of gas as required by the Contract. Valero's failure is a breach of the Contract for which Lively is entitled to recover.

Pursuant to Article VIII, ¶ 8.2, of the Contract, Lively calculated the amount due from Valero under the take-or-pay provision to be $21,264,689.30 (P. Ex. 51; S.F. 398). Article VIII, ¶ 8.2, provides:

> If Buyer shall fail in any contract year of the term hereof to take the quantity of gas that Buyer is obligated to take hereunder, then Seller shall, within sixty (60) days after such contract year render a bill to Buyer based upon the weighted average price, including tax reimbursement, in effect hereunder during the contract year in which such deficiency occurred, computed on the volumes delivered during the year and at the price, including tax reimbursement, applicable to such volumes at the time of delivery thereof. If Buyer agrees with such statement, Buyer will make payment to Seller for the amount of such statement within sixty (60) days after receiving Seller's statement. In computing the amount due Seller for any deficiency in takes by Buyer occurring during any contract year, there shall be deducted from such deficiencies the following quantities:
>
> (a) The total of the quantities which Buyer requested, up to 111% of the Daily Contract Quantity, and which Seller failed to deliver for any reason on any day or days during such contract year; and,
>
> (b) The total of the quantities of gas which Buyer was unable to take or failed to take on any day

> or days during such contract year by reason of force majeure; and,
>
> (c) The total of the quantities of gas by which there was a deficiency in Seller's allowable for the wells covered hereby below the Daily Contract Quantity on any day or days during such year, excluding any portion of such deficiency which is caused by, or is a result of, Buyer's failure to nominate to the Texas Railroad Commission to purchase a quantity of gas equal to the Daily Contract Quantity; and
>
> (d) The total of the quantities of gas which Buyer refuses to take on any day or days during such year by reason of Seller's failure to meet any of the quality specifications or pressure requirements provided hereunder.

On September 29, 1983, Lively filed Plaintiffs' Original Petition in the 112th Judicial District Court of Sutton County (Tr. 3). Valero answered with a general denial and alleged numerous affirmative defenses to its liability.

On or about September 5, 1985, the Honorable Lawrence Fuller, Judge of the 143rd Judicial District Court, was assigned to hear this case on the withdrawal of the sitting District Court Judge, the Honorable Brock Jones. On September 16, 1985, the Trial Court granted Lively's Motion for Partial Summary Judgment as to liability only against Valero (Tr. 8). On or about October 29, 1986, the Honorable Bob Parks, having succeeded to the position of Judge of the 143rd Judicial District Court upon the appointment of the Honorable Lawrence Fuller to the El Paso Court of Appeals, entered an order setting aside the Order for Partial Summary Judgment (Tr. 29). Trial on the merits commenced on April 13, 1987. The jury returned their answers to special issues on April 22,

1987. On May 4, 1987, the Trial Court entered the judgment complained of herein and on May 11, 1987 denied Lively's Motion for Partial New Trial. Lively has timely perfected its appeal to this Court.

The Trial Court submitted this case to the jury by way of five special issues. Special Issues 1 and 1A inquired whether Lively and Valero modified the Contract to include under its terms and conditions the gas produced from certain wells (Tr. 143, 144). The jury answered both special issues in the affirmative, and Lively makes no complaint to this Court as to those findings.

The Trial Court submitted Lively's take-or-pay claim by way of two special issues to the jury. Special Issue 2 inquired whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?" (Tr. 145). Special Issue 3, concerning the amount of money that Valero owed to Lively for its failure to take or pay under the contract, was conditionally submitted by the Trial Court (Tr. 147). Special Issues 4 and 4a concern Lively's claim for underpayment by Valero for gas that Valero actually took (Tr. 150, 151). Special Issue 5 inquired about the reasonable and necessary attorneys' fees incurred by Lively in prosecuting this action (Tr. 152). Lively makes no complaint to this Court concerning the findings of Special Issues 4, 4a, and 5, which have been incorporated in the judgment on appeal herein.

ARGUMENT AND AUTHORITIES

POINT OF ERROR ONE RESTATED: The Trial Court erred in admitting evidence of the Railroad Commission's gas market demand rule offered by Valero in support of its contention that such rule relieved Valero of its take-or-pay obligations under the contract, because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas (S.F. 1680-1681).

POINT OF ERROR TWO RESTATED: The Trial Court erred in including the gas market demand rule in Instruction 2 to Special Issue 2, because, as a matter of law, the Texas gas market demand rule does not relieve Valero of its contractual obligation to pay for the Daily Contract Quantity of gas (S.F. 1680-1682; Tr. 145-146).

Points of Error One and Two will be argued together, since both points relate to the application of the Texas gas market demand rule as a defense to take-or-pay obligations under natural gas contracts.

Article V, ¶ 5.3, of the Contract contains the take-or-pay provision relied upon by Lively in this case. Valero seeks to avoid its obligations under that provision by asserting that the Railroad Commission gas market demand rule abrogates the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity of gas not taken. It is Appellants' position that as a matter of law the Railroad Commission gas market demand rule does not affect the rights and obligations of the parties to this Contract by relieving Valero of its obligation to pay for this minimum quantity of gas provided by the Contract.

Take-or-pay provisions in various forms have been recognized as standard provisions in gas purchase agreements since the early 1950's. 4 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 724.5 (1983). Courts have consistently held that such provisions are common in the industry and are not unconscionable or unfair. *Universal Resources Corp. v. Panhandle Eastern Pipeline Co.*, 813 F.2d 77 (5th Cir. 1987). The purpose of such clauses is to apportion the risks of natural gas production and sales between the buyer and seller. "The seller bears the risk of production. To compensate seller for that risk, buyer agrees to take, *or pay if not taken*, a minimum quantity of gas." *Universal Resources*, 813 F.2d at 80.

The Texas Railroad Commission's gas market demand rule clearly does not relieve Valero of its alternative obligation to pay for the Daily Contract Quantity of gas as required by the take-or-pay provisions of the Contract. The gas market demand rule and the associated ratable-take requirements relate to the *production* and *taking* of gas to prevent waste and protect correlative rights. They do not regulate the payment for gas not taken under take-or-pay provisions or natural gas contracts. No Texas statute or Railroad Commission regulation, either expressly or by implication, prohibits or excuses a purchaser from *paying for* the quantity of gas that purchaser has contractually obligated itself to pay. The Railroad Commission and the courts have recognized that contractual obligations to pay for gas not taken are not superseded by the gas market demand rule.

An attempt by the Railroad Commission to declare by regulation that the gas market demand rule relieved purchasers of contractual take-or-pay obligations was held invalid almost immediately after its adoption. On February 22, 1977, the Railroad Commission issued an interpretive order relating to the gas market demand rule, in which the Commission attempted to declare that take-or-pay provisions were invalid to the extent they contravened the provisions of that order. What has become known as the "penultimate paragraph" read as follows:

> IT IS FURTHER ORDERED that the provisions of any and all purchase or other agreements between producers and gas purchasers which contravene or are inconsistent with the provisions of this Order and [sic] are rendered inoperative, including, without limitation, provisions relative to (1) gas purchasers nominating to take gas in certain amounts or at certain levels, (2) producers asserting penalties, damages or other remedies against gas purchasers in the event of reductions in or cancellation of allowables and (3) *obligations requiring gas purchasers to take, or pay for it not taken, quantities greater than allowables set by this Commission.*

Railroad Commission Gas Well Allowable Order, 2 Tex. Reg. 785, 788 (1977).

Three lawsuits were filed in the Travis County district courts challenging the validity of that order. In one of those cases, *Dallas Production Co. v. Railroad Commission*, No. 260,641 (Dist. Ct. of Travis County, 53rd Judicial Dist. of Texas, June 10, 1977), the plaintiff asserted that the above-quoted paragraph was invalid because the Railroad Commission had exceeded its statutory authority by attempting to regulate take-or-pay contracts.[2] The Court held that the order was unlawful, invalid, and of no force and effect, stating:

> The Court further finds that the above quoted penultimate paragraph herein declared invalid does not affect the rights, duties or obligations of Brazos Electric Power Cooperative, Inc. and Brazos Fuel Company, Inc., Intervenors, and Plaintiff producers under the take or pay provisions of their gas purchase agreements.

The Railroad Comission did not appeal this judgment and subsequently repromulgated the order without the invalid paragraph, and it became regularly adopted as the gas market demand rule. 3 Tex. Reg. 324 (1978). That rule with minor revisions was in effect during the 1982-1986 period covered by this litigation.

From the history surrounding its adoption, it is plain that the Texas gas market demand rule does not and cannot have the effect of overriding take-or-pay provisions in gas purchase agreements between producers and pipelines and does not provide a defense for the breach of those contractual obligations. This is clear from the district court's holding invalid that portion of the interpretive order which stated that the rule superseded private contractual provisions and the Railroad Commission's subsequent omission of the offending language in the replacement interpretive order.

In adopting the current gas market demand rule, rules 30 and 34 (sections 3.30 and 3.34), the Railroad Commission again stated that such regulations were not intended to modify existing private contractual relationships. In the preamble, the Railroad Commission carefully describes the scope of those rules:

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[2] Appendix at A1-A2.

> Sections 3.30 and 3.34 are not intended to be a comprehensive statement of rights or obligations under the Common Purchaser Act, nor are they intended to preclude any complaints which may arise under the Act. *These amendments shall not affect existing contractual rights and obligations between parties.* 12 Tex. Reg. 536 (1987).

Courts have also rejected a gas market demand rule defense in the nature of that raised herein by Valero. In *Phillips v. Delhi Gas Pipeline Corp.*, No. 83-141 (Dist. Ct. of Houston County, 3rd Judicial Dist. of Texas, Oct. 21, 1986),[3] a partial summary judgment with respect to liability was rendered in favor of the plaintiffs on their take-or-pay claim. The defendants raised the gas market demand rule as a defense to the plaintiffs' claim. The court, in granting partial summary judgment, stated that "Defendants are liable for failing to take delivery from or pay Plaintiffs for the Daily Contract Volume of natural gas during each of the Annual Periods" and that the market demand rule and other defenses asserted by the pipelines "are not legally sufficient defenses to Plaintiffs' claims." *See also El Paso Natural Gas Co. v. G.H.R. Energy Corp.*, No. 85-09329 (Dist. Ct. of Harris County, 127th Judicial Dist. of Texas, Oct. 10, 1986),[4] where the court in granting the producers' motion for partial summary judgment, held that, "as a matter of law, the take-or-pay provision . . . is enforceable and performance is not excused on any basis, . . . including regulation by federal or state governmental authority. . . ."

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[3] Appendix at A3.

[4] Appendix at A4.

Valero contends that the gas market demand rule modifies Valero's contractual take-or-pay obligation. Under Valero's theory, the gas market demand rule requires Valero to limit its purchases of gas from any producer to that producer's proportionate share of the downstream market demand. In essence, Valero argues that deliverability under the Contract is determined by Valero's market demand. Under Valero's contention, Valero's takes will always equal deliverability, and there can never be a deficiency under the take-or-pay provision of the Contract requiring Valero to pay for gas not taken.

Valero's contention fails to recognize the purpose and effect of the alternative performance obligations under the take-or-pay provision of the Contract. The courts have recognized that the take-or-pay clause is an alternative performance provision. *International Minerals & Chemical Corp. v. Llano, Inc.*, 770 F.2d 879 (10th Cir. 1985); *Superior Oil Co. v. Transco Energy Co.*, No. 84-2138-"L" (W.D. La. 1985).[5] Valero can perform by either (1) taking and paying for the specified minimum quantity of gas for the Contract Year or (2) paying for that minimum quantity of gas even though not taken during the Contract Year.

In *International Minerals*, the defendant International Minerals ("IMC") was the operator of a potash mine and processing facility in New Mexico. In 1972, IMC entered into a contract with plaintiff to purchase gas needed to run some of its equipment. In 1978, the New Mexico Environmental Improvement Board enacted Regulation 508, which limited emissions from potash processing equipment. In employing new technology necessary to comply with the regulation, IMC did not take or pay for the minimum quantity of gas as required under the contract. IMC alleged that the enactment of Regulation 508 was an event of force majeure and relieved it of any performance obligations under the gas purchase contract. The court rejected that position, stating:

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[5] Appendix at A5.

> [E]ven if we assume arguendo that Rule 508 prevented IMC from taking the gas, Rule 508 would still pose no obstacle to IMC's ability to pay. Since this is a "take-or-pay" contract the buyer can perform in either of two ways. It can either (1) take the minimum purchase obligation of natural gas (and pay) or (2) pay the minimum bill. It is settled law that when a promisor can perform a contract in either of two alternative ways, the impracticability of one alternative does not excuse the promisor if performance by means of the other alternative is still practicable. (Citations omitted) *Paragraph 15 [the force majeure clause] does not compel a different result; it would at most excuse IMC from its duty to "take," not from its duty to "pay."*

770 F.2d at 885.

In *Kaiser-Francis Oil Co. v. Producer's Gas Co.*, No. 83-C-400-B (N.D. Okla. June 19, 1985),[6] and *Southport Exploration Inc. v. Producer's Gas Co.*, No. 83-C-550-B (N.D. Okla. June 6, 1984),[7] the courts addressed the argument that a pipeline company had no obligation to make take-or-pay payments because production of the gas not taken would have exceeded the market demand for the gas and thus would have constituted waste under the Oklahoma conservation statutes. The court in *Kaiser-Francis,* recognizing the alternative performance obligations of a take-or-pay provision, specifically held that take-or-pay provisions are enforceable under the state market demand rule and statutes intended to prevent waste since *"the take-or-pay provisions of the contract do not require production, but rather provide for payment in lieu of production."*[8] In rejecting the pipeline company's argument, the court stated that such an "interpretation would render the take-or-pay provisions of the contracts virtually useless."[9]

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[6] Appendix at A36.

[7] Appendix at A47.

The definition of "waste" is virtually the same in the Texas and Oklahoma conservation statutes. Section 86.012 of the Texas Natural Resources Code defines the term waste to include "the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced." Section 86.3 of 52 Oklahoma Statutes Annotated provides "the term 'waste', as applied to gas, in addition to its ordinary meaning, shall include . . . waste incident to the production of natural gas in excess of transportation and marketing facilities or reasonable market demands."

Alternative performance obligations have consistently been upheld by Texas courts. *Moss & Raley v. Wren,* 102 Tex. 567, 120 S.W. 847 (1909); *Kirkland v. Gaston,* 544 S.W.2d 694 (Tex. Civ. App.—Dallas 1976, no writ);

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[8] Appendix at A46.

[9] Appendix at A42.

Carter v. Smith, 184 S.W. 244 (Tex. Civ. App.—Dallas 1916, no writ). Where a contract provides for alternative performance obligations, the fact that one alternative is prevented does not relieve the party from performing the second alternative. *Yankton Sioux Tribe of Indians v. United States,* 272 U.S. 351 (1926); *Ashland Oil & Refining Co. v. Cities Service Gas Co.,* 462 F.2d 204 (10th Cir. 1972); S. WILLISTON, CONTRACTS § 1961 (1971 and 1984 Supp.).

No cases have been found which hold that the enforcement of the alternative *pay* obligation of a take-or-pay provision is excused by the Texas gas market demand rule absent some specific contract language so providing. Any decision to the contrary would be illogical. The enforcement of the alternative *pay* obligation neither requires the producer to *produce* more gas than allowed by law nor requires the purchaser to *take* more gas than the market demand or discriminate among its producers.

Commentators have reached this same conclusion. In a recent article discussing the argument that the Texas gas market demand rule insulates pipeline purchasers from take-or-pay liability, one writer critiqued the argument this way:

> The pipeline argument has two parts: (1) that the prorationing and ratable take rules serve as a cap on the ability to take; and (2) that where the state says "thou shall not take," the state is also saying "thou shall not pay."
>
> . . . .
>
> The second part of the pipeline argument against take-or-pay clauses appears to be a non sequitur. Unless a contract provision excuses payment for gas

> in excess of quantities which the state permits to be taken, why should a regulatory limit on the ability to take also be a limit on the duty to pay? The Railroad Commission has no direct authority to relieve anyone of their contractual bargains. And the legislature has not adopted any explicit statutory controls over take-or-pay clauses. It would seem, therefore, that the take-or-pay issue should be considered entirely one of contract.

A. Anderson, *The Texas Approach to Gas Proration and Ratable Take,* 57 COLO. L. REV. 199, 221 (1986).

If the gas market demand rule has the effect asserted by Valero, the take-or-pay provision of the Contract becomes meaningless. It is well recognized that parties to and an instrument generally intend that every clause has some effect and purpose. *Pinehurst v. Spooner Addition Water Co.,* 432 S.W.2d 515 (Tex. 1968). Thus, Texas case law makes it clear that a contract should be construed in a manner which gives effect to all of its provisions. *Coker v. Coker,* 650 S.W.2d 391 (Tex. 1983); *Universal C.I.T. Credit Corp. v. Daniel,* 150 Tex. 513, 243 S.W.2d 154 (1951); *Sun Oil Co. v. Burns,* 125 Tex. 549, 84 S.W.2d 442 (1935); *Williams v. J & C Royalty Co.,* 254 S.W.2d 178 (Tex. Civ. App.—San Antonio 1952, writ ref'd). Accordingly, courts should avoid the adoption of a construction which would render any provision meaningless. *Mattison, Inc. v. W. F. Larson, Inc.,* 529 S.W.2d 271 (Tex. Civ. App.—Amarillo 1975, writ ref'd n.r.e.). A court has no right to nullify any terms of an agreement. *Williams v. J & C Royalty Co., supra.*

This Court's recent opinion in *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.,* Appeal No. 04-84-00499-CV (Tex. App.—San Antonio, May 13, 1987, no writ) (not yet reported), is not applicable to this appeal. In *Kodiak*, this Court affirmed a judgment based upon a finding that the "gas market failure" there relied upon by the pipeline company "excused Delhi's performance under the gas purchase agreement by virtue of the 'force majeure' provision of such agreement." (Slip opinion at 5). However, in this case, the jury made no such finding. The "force majeure" provision of the Contract was set forth in Instruction 3(c) of Special Issue 3, which was conditionally submitted by the Trial Court and not answered by the jury because of its answer to Special Issue 2. Further, there is a significant difference between the force majeure clause involved in *Kodiak* and that involved in the Contract here. The force majeure clause there defined "force majeure" in pertinent part as meaning "partial or entire failure to gas supply or market." The force majeure clause in the Contract here defines "force majeure" in pertinent part as including "temporary failure of wells or sources of supply of gas, or markets." There was no evidence presented by Valero in the trial of this case that Valero's failure to take or pay for Lively's gas was the result of a "temporary failure of wells or sources of supply of gas, or markets." For the above reasons, *Kodiak* is not applicable here.

It is clear from the above that the take-or-pay provisions of the Contract are an essential condition of the Contract and are binding upon Valero. Valero is not relieved from compliance with those provisions by the Texas gas market demand rule, and to uphold Valero's reliance upon that rule would render this take-or-pay provision of the Contract meaningless and deprive Lively of the protection of that important provision.

POINT OF ERROR THREE RESTATED: The Trial Court erred in the definition of the term "deliverability" used in Instruction 2 to Special Issue 2 (S.F. 1675; Tr. 145).

POINT OF ERROR FOUR RESTATED: The Trial Court erred in failing to define the term "deliverability" as it is used in the take-or-pay provision of the gas purchase contract (S.F. 1676-1682; Tr. 145).

Points of Error Three and Four will be argued together, as they both relate to the Trial Court's definition of "deliverability." The Trial Court clearly erred in the instructions to Special Issue 2 by defining the term "deliverability" as set forth in Article I(j) instead of as set forth in Article V, ¶ 5.3, which is the take-or-pay provision of the Contract. Under the Contract, Valero's take-or-pay liability is determined by comparing actual purchases of gas to ninety percent (90%) of "deliverability." The Contract expressly sets forth how "deliverability" is to be determined for take-or-pay purposes in Article V, ¶ 5.3, wherein it is stated:

> Upon request by Buyer or Seller, *Seller's Deliverability shall be determined and established by Buyer by testing the actual ability of Seller's wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90) day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points of delivery at the time of the test.

The evidence at trial established that Lively tested the actual ability of its wells to deliver into Valero's facilities and that the results of the tests were found in Lively's Form G-10 filings with the Railroad Commission (S.F. 227-231). The Court admitted Lively's Form G-10's into evidence (P. Ex. 13; S.F. 243). Lively calculated its take-or-pay damages based on the actual ability of the wells to deliver (P. Exs. 42, 49-51; S.F. 370, 442), in conformity with the express language of the take-or-pay provision in Article V, ¶ 5.3, of the Contract.

The Trial Court, however, used the wrong definition of the term "deliverability" in its instructions. The Court did not instruct the jury that "deliverability" for take-or-pay purposes means the actual ability of the wells to deliver into Valero's facilities, but instead gave the following instruction in connection with Special Issue 2:

> Lively's daily 'Deliverability' is defined by the Contract to be that quantity of gas which Lively had available for delivery from the Lands and Leases to Valero during each day in conformity with the requirements of the Contract, at a constant rate of flow, when Lively's wells were not produced in excess of their maximum efficient rate of flow, but not in excess of the maximum (including overproduction) rate of flow permitted by the laws. rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction. (Tr. 145).

Lively properly objected to the Trial Court's submission to the jury of Special Issue 2 and its accompanying instructions (S.F. 1675), thereby preserving error.

The Trial Court's error in submitting the wrong definition of "deliverability" in its instructions to Special Issue 2 is shown by a comparison of the Contract's use of the term in the definitions section of the Contract (Art. I(j)) and in the take-or-pay clause (Art. V, ¶ 5.3):

Art. I(j)	*Art. V, ¶ 5.3*
(j) The term "Deliverability" means that quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.	Upon request by Buyer or Seller, *Seller's Deliverability shall be determined and established by Buyer by testing the actual ability of Seller's wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such deliverability tests more often than once in any ninety (90) day period. Such deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points delivery at the time of the test. . . .

To be proper, an explanatory instruction or definition must be correct. *Sanders v. Davila,* 593 S.W.2d 127 (Tex. Civ. App.—Amarillo 1979, writ ref'd n.r.e.). An explanatory instruction is improper if it is a misstatement of the law as applicable to the facts. *Wakefield v. Bevly,* 704 S.W.2d 339 (Tex. App.—Corpus Christi 1985, no writ). An erroneous definition given by the court may amount to prejudicial error requiring reversal. *Gage v. Langford,* 582 S.W.2d 203 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.). Furthermore, an instruction which shifts to the jury the determination of a legal issue that should have been determined by the Trial Court involves the submission to the jury of a question of law, which is improper and requires reversal. *Foerster v. Peoples,* 362 S.W.2d 918 (Tex. Civ. App.—Amarillo 1962, no writ); *Barton v. Davis,* 441 S.W.2d 299, 301 (Tex. Civ. App. —El Paso 1969, writ ref'd n.r.e.); *Emmond's Inc. v. Obermiller,* 526 S.W.2d 562, 566 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.).

The definition submitted by the Trial Court required the jury to determine the legal issue of whether the gas market demand rule, a regulation by an administrative agency, modifies existing contractual relationships between private parties. As discussed in Appellants' first and second points of error, as a matter of law the gas market demand rule does not affect private contract rights. The Trial Court's erroneous definition of the term "deliverability" in the instructions to Special Issue 2 was reasonably calculated to cause and did cause the rendition of an improper judgment, and the Trial Court's judgment in that respect should be set aside.

POINT OF ERROR FIVE RESTATED: The Trial Court's instructions to Special Issue 2 were prejudicial comments on the weight of the evidence (Tr. 145-146).

The Trial Court's instructions given with respect to Special Issue 2 were prejudicial comments on the weight of the evidence. In Instruction 2, the Court stated, in part:

> The term market demand means that amount of gas needed for current consumption.
>
> You are instructed that the production, transportation, or use of gas in a manner, in an amount, or under conditions which constitute waste is unlawful and is prohibited.
>
> You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced.

These instructions by the Trial Court constituted an impermissible comment that tilted or nudged the jury in favor of Valero, in violation of the Supreme Court's holding in *Lemos v. Montez,* 680 S.W.2d 798, 801 (Tex. 1984). In *Lemos*, the Court held that even legally correct instructions are not proper when they direct the jury towards a particular answer to a special issue. 680 S.W. 2d at 801.

Here, even if the Trial Court's definition of the term "waste" is accurate, it was irrelevant. There was no need for the Court to instruct the jury on "waste." Valero had the option of fulfilling its obligations under the Contract by either taking and paying for the Daily Contract Quantity or by merely paying for that gas. The Contract neither obligates Lively to produce, nor Valero to purchase, gas wastefully. Instead, the Contract specifically provides for payment in lieu of production. *Kaiser-Francis, supra.* There are no conservation statutes prohibiting Valero from paying even when it cannot take gas.

The Trial Court further commented improperly on the weight of the evidence by its quote from Article V, ¶ 5.2, of the Contract in Instruction 2, which stated:

> You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as Valero may from day to day elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow (Tr. 145).

This instruction was not necessary to enable the jury to answer Special Issue 2. It impermissibly diverted the jury's attention from the central issue in Special Issue 2—Did Valero fail to take or pay for an amount of gas equal to the Daily Contract Quantity? Its effect was to imply to the jury that Valero controls the quantity of gas that it is required to take and pay for or pay for if not taken. This implication is clearly contrary to the express terms of the Contract.

Submission of unnecessary instructions may be so prejudicial as to require reversal. *Samsel v. Diaz,* 659 S.W. 2d 143 (Tex. App.—Corpus Christi 1983, no writ). An unnecessary instruction that constitutes a comment on the weight of the evidence or which diverts the jury's attention from a central issue is error. *Lemos v. Montez, supra; City of San Antonio v. Roper Corp.,* 686 S.W.2d 602 (Tex. 1985).

Here, the Trial Court's error was clearly prejudicial to Lively. The jury found that Valero did not fail to take the Daily Contract Quantity when the evidence clearly established that Valero failed to do so and that Lively was damaged by that failure in an amount in excess of

$20 million. The Trial Court's submission of these instructions was improper, constituted judicial comments on the weight of the evidence, was highly prejudicial to Lively, and caused the rendition of an improper judgment.

POINT OF ERROR SIX RESTATED: The Trial Court erred in conditionally submitting Special Issue 3 (S.F. 1682; Tr. 147).

The errors in the Trial Court's instructions with respect to Special Issue 2 were compounded by the Court's conditionally submitting Special Issue 3, which was the ultimate or controlling issue in this case. Special Issue 3 in pertinent part was as follows:

> "What sum of money, if any, if paid now in cash, do you find to be due and owing to Lively under the Contract?" (Tr. 147).

Rules 277 and 279 of the Texas Rules of Civil Procedure provide that each party is entitled to have submitted to the jury the controlling issues for each ground of recovery or defense raised by the written pleadings and evidence in the case. Texas courts have long recognized this right. *Blanton v. E. & L. Transport Co.,* 146 Tex. 377, 207 S.W.2d 368 (1948); *Montgomery v. Gay,* 212 S.W.2d 941 (Tex. Civ. App.—Fort Worth 1948, no writ). "[T]his right cannot be lost or defeated by jury findings on other issues, which, in effect, indirectly negative a favorable finding on an issue not submitted, but raised by the evidence." *Blanton,* 207 S.W.2d at 369.

The conditional submission of special issues is not authorized where fundamental rights of the parties may be adversely affected. Accordingly, when the effect of conditionally submitting an issue is to deprive the plaintiff of the submission of an independent ground of recovery, conditioning the issue is erroneous, 3 R. McDONALD, TEXAS CIVIL PRACTICE IN DISTRICT AND COUNTY COURTS §§ 12.16.1 and 12.16.2(b) (rev. 1983). The only appropriate solution is to remand the matter for a new trial.

Under the rules relating to special issue practice, only controlling or ultimate issues should be submitted to the jury. TEX. R. CIV. P. 277 and 279; *Holmes v. J. C. Penney Co.*, 382 S.W.2d 472 (Tex. 1964); *Rocha v. Ahmad*, 676 S.W.2d 149 (Tex. App.—San Antonio 1984, writ dism'd). Evidentiary issues, those which are embraced within or tend only to establish the fact of the controlling issue, should not be submitted to the jury. *Lambert v. H. Molsen & Co., Inc.*, 551 S.W.2d 151 (Tex. Civ. App.—Waco 1977, writ ref'd n.r.e.). An evidentiary issue may be considered by the jury in deciding the controlling issue, but it is not a controlling issue itself and should not be submitted. *Sell v. C.B. Smith Volkswagen, Inc.*, 611 S.W.2d 897 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.).

As was argued by Lively at the charge conference (S.F. 1682-1683), Special Issue 3 was tthe ultimate and controlling issue in the case. The Daily Contract Quantity inquired about in Special Issue 2 was simply one of the many evidentiary matters to be considered by the jury in deciding the controlling issue. The Trial Court's conditional submission of the controlling issue in the case, predicated on a response to an evidentiary issue which should not have been submitted, deprived Lively of its right to have the controlling issue with respect to one of its grounds for recovery determined by the jury. In effect, Lively's entire take-or-pay cause of action was submitted conditionally.

The conditional submission of Special Issue 3 was extremely prejudicial to Lively, constituted harmful error, and led to the rendition of an improper judgment.

POINT OF ERROR SEVEN RESTATED: The Trial Court erred in entering judgment for Valero on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because, as a matter of law, there was no evidence to support the finding.

POINT OF ERROR EIGHT RESTATED: The Trial Court erred in entering judgment on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because the only evidence in support of that finding is legally incorrect and is factually insufficient to support the finding.

POINT OF ERROR NINE RESTATED: The Trial Court erred in entering judgment on and failing to set aside the jury's finding on take-or-pay liability (Special Issue 2, Tr. 145), because the finding was against the great weight and preponderance of the credible evidence, which conclusively showed that Valero failed to take or pay for the Daily Contract Quantity of gas.

Points of Error Seven through Nine will be argued together, since they involve the determination of the central issue in this case—Valero's take-or-pay liability.

Appellants attack the judgment from three standpoints: (1) there was no evidence to support the jury's finding on take-or-pay liability; (2) there was insufficient evidence to support the jury's finding on take-or-pay liability; and (3) the jury's finding on take-or-pay liability was against and contrary to the great weight and preponderance of the evidence. Each of these arguments will be covered below under descriptive subheadings.

Special Issue 2 asked the jury to find whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?" The jury answered "No." This finding is unsupported by the evidence. The Contract defines "Daily Contract Quantity" as that quantity of gas equal to ninety percent (90%) of Lively's daily deliverability. The Trial Court used this definition in its instruction to Special Issue 2. All of the evidence presented to the jury, with but one exception, showed that Valero failed to take or pay for the quantity of gas equal to the Daily Contract Quantity. Lively presented extensive testimony concerning Valero's failure to take or pay for the Daily Contract Quantity during the Contract Years 1982, 1983, 1984, and 1985 (P. Exs. 38-42, 49-51, 57-60; S.F. 367-401). Even Valero's own evidence, with one exception, proved that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity.

Valero presented Herbert E. Warner, a partner with the accounting firm of Peat Marwick & Main, as an expert witness (S.F. 1384). Mr. Warner presented a series of exhibits calculating Valero's take-or-pay deficiency. Mr. Warner presented seven different "scenarios" showing Valero's take-or-pay deficiency. Six of these seven scenarios proved that Valero had failed to take or pay for a quantity of gas equal to the Daily Contract Quantity (D. Exs. 79-90). Only one out of Valero's own seven scenarios showed that Valero had not failed to take or pay for a quantity of gas equal to the Daily Contract Quantity (D. Exs. 78 and 91). However, that one scenario is based solely on the assumption that the term "deliverability" is the equivalent of the amount of gas that Valero actually took from Lively pursuant to the gas market demand rule. As heretofore discussed under Points of Error One and Two, the gas market demand rule does not abrogate Valero's obligation to pay for a quantity of gas equal to the Daily Contract Quantity. Valero's evidence based on this erroneous assumption is equally incorrect and thus constitutes no evidence.

Therefore, the only legally sufficient evidence presented to the jury concerning Valero's failure to take or pay for a quantity of gas equal to the Daily Contract Quantity proves that Valero did fail to take or pay for that quantity of gas as required by the Contract during each of the Contract Years involved.

A. There was no evidence to support the jury's finding on take-or-pay liability.

A "no evidence" point of error must be sustained when the record discloses one of the following:

(1) a complete absence of evidence of a vital fact;

(2) the court is barred by rules of law or evidence from giving weight to the only evidence offered to prove a vital fact;

(3) the evidence offered to prove a vital fact is no more than a mere scintilla of evidence; or

(4) the evidence establishes conclusively the opposite of a vital fact.

Royal Indemnity Co. v. Little Joe's Catfish Inn, Inc., 636 S.W.2d 530, 531 (Tex. App.—San Antonio 1982, no writ); R. Calvert, *"No Evidence" and "Insufficient Evidence" Points of Error*, 38 TEX. L. REV. 361, 363-365 (1960). In determining a "no evidence" point, the court is to consider only the evidence and inferences which tend to support the finding of the jury and disregard all evidence and inferences to the contrary. *Larson v. Cook Consultants, Inc.*, 690 S.W.2d 567, 568 (Tex. 1985).

In the present case, the evidence presented by both parties conclusively established that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity during each of the Contract Years involved. The evidence to the contrary is based entirely on Valero's invalid argument that the gas market demand rule abrogates its obligations under the Contract. Therefore, this Court is barred from considering the only evidence in the record which supports the jury's finding with respect to Special Issue 2.

When the jury finds the nonexistence of a vital fact or gives a negative answer to an issue inquiring as to the existence of a vital fact, its finding or answer need not be supported by evidence, and error can occur only if the facts have been conclusively established or established as a matter of law. *Jordan v. Ortho Pharmaceuticals, Inc.*, 696 S.W.2d 228, 235 (Tex. App.—San Antonio 1985, no writ); *Pouncy v. Garner*, 626 S.W.2d 337 (Tex. App. —Tyler 1981, writ ref'd n.r.e.). When reviewing "matter of law" points, the Court should consider all of the evidence, and if the converse of the jury's findings is established conclusively, the point will be sustained. R. Calvert, *supra* p. 32, at 363-364; *Jordan*, 696 S.W.2d at 235.

Here, Lively conclusively established that Valero failed to take or pay for a quantity of gas equal to the Daily Contract Quantity in each of the Contract Years involved. The only evidence in the record to support the finding that Valero did not fail to take or pay for the minimum amount was presented in Defendant's Exhibits 78 and 91. Those exhibits are based entirely upon Valero's contention that the gas market demand rule abrogates Valero's obligations under the Contract (S.F. 1449). As heretofore shown, Valero's contention is incorrect as a matter of law.

B. There was insufficient evidence to support the jury's finding on take-or-pay liability, and the jury's finding was against the great weight and preponderance of the evidence.

When considering an "insufficient evidence" point of error, the court should consider and weigh all of the evidence in the case, including that in support of and that contrary to the challenged finding, to determine if the finding is so contrary to the great weight and preponderance of the evidence as to be clearly wrong and unjust. *Dyson v. Olin Corp.*, 692 S.W.2d 456, 457 (Tex. 1985); *Garza v. Alviar*, 395 S.W.2d 821, 823 (Tex. 1965). The court must let the jury, as the trier of fact, judge the credibility of the witnesses, assign the weight to be given to their testimony, and resolve any conflicts in the testimony. However, here the only evidence in support of the jury's finding as to Special Issue 2 was wrong as a matter of law. As discussed in Points of Error One and Two, the gas market demand rule did not abrogate Valero's obligations under the Contract. Valero's sole evidence in favor of the jury's finding has no probative value. The jury's finding is against the great weight and preponderance of the evidence, presented by both Lively and Valero, that Valero failed to take or pay for the minimum quantity of gas for each of the Contract Years involved. The challenged finding is against the great weight and preponderance of the evidence so as to be clearly wrong and unjust, and this Court should set the finding aside and order a new trial as to that part.

The jury's finding with respect to Special Issue 2 is supported by no evidence, by insufficient evidence, is contrary to the great weight and preponderance of the evidence, is clearly wrong and unjust, and is incorrect as a matter of law. For these reasons, Appellants respectfully submit that this Court should reverse the judgment of the Trial Court and render judgment that Valero is liable to Lively for Valero's failure to pay for the Daily Contract Quantity under the Contract for the Contract Years 1982, 1983, 1984, and 1985 and remand this case to the Trial Court for a determination of the amounts owed to Lively by Valero as a result of such failure.

CONCLUSION

The Trial Court clearly erred in the respects set forth in the above Points of Error, and those errors did cause rendition of an improper judgment in the case in part, which is clearly separable without unfairness to the parties.

Therefore, it is respectfully submitted that under Rule 81 of the Texas Rules of Appellate Procedure that the judgment should be reversed as to the part complained of by Appellants, judgment rendered in favor of Lively with respect to liability, and a new trial ordered to determine the amount of damages owed to Lively by Valero.

PRAYER FOR RELIEF

Appellants respectfully request that this Court reverse the judgment of the Trial Court that Lively take nothing by way of their take-or-pay cause of action, render judgment that Valero is liable to Lively for its failure to pay for the Daily Contract Quantity under the Contract for the Contract Years 1982, 1983, 1984, and 1985, remand the case for a new trial as to the amount owed to Lively by Valero, in all other respects affirm the Trial Court's judgment, and grant Appellants Lively such other and further relief to which they be justly entitled.

Respectfully submtited,

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CERTIFICATE OF SERVICE

I hereby certify that the above and foregoing Brief for Appellants, together with the Appendix thereto, was served on Appellee or its attorney by delivery of a true copy by certified mail, return receipt requested, by depositing it, postpaid, in an official depository under the care and custody of the United States Postal Service on the 26th day of August, 1987, enclosed in a wrapper addressed as follows:

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JESSE P. LUTON, JR.

NO. 04-87-00380-CV

IN THE COURT OF APPEALS FOR THE
FOURTH SUPREME JUDICIAL DISTRICT
OF TEXAS AT
SAN ANTONIO, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants

v.

VALERO TRANSMISSION COMPANY,
Appellee

APPEALED FROM THE DISTRICT COURT
OF SUTTON COUNTY
112th DISTRICT COURT OF TEXAS

APPELLEE'S BRIEF

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APPELLEE REQUESTS ORAL ARGUMENT

COMPLETE LIST OF THE PARTIES

Pursuant to Rule 74(c) of the Texas Rules of Appellate Procedure, a complete list of the names of all parties follows:

Appellants:

Lively Exploration Company
Lea Roy Aldwell, Individually
Lea Roy Aldwell
Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased
Jon A. Sonnen
J. Howard Marshall
Ed Farrell
Elizabeth Standish
The Desana Corporation
Jessee L. Dally
Chester H. Kenley
Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased
H. B. Lively
B. Jackson Bandy
Robert L. Banks
Theo B. Bean
William R. Gifford
Charlie Gill, Jr.
Henry Gunders and wife, Elaine Gunders
Kenneth L. Hewitt
Kallman Nashner
Frank Pace, Jr.
Martin B. Seretean
Ray B. Vaughters
Theodore L. Wilkinson

Appellee:

Valero Transmission Company

I. NATURE OF THE CASE

Appellants Lively Exploration Company, et al. are appealing the trial court's take-nothing judgment against them on their claim against Valero for breach of a "take-or-pay" provision in a gas purchase contract.

II. REPLY POINTS OF ERROR

First Reply Point of Error:

THE TRIAL COURT DID NOT ERR IN ADMITTING EVIDENCE OF THE RAILROAD COMMISSION'S GAS MARKET DEMAND RULE OFFERED BY VALERO (Reply To Appellants' Point Of Error One).

Second Reply Point of Error:

THE TRIAL COURT DID NOT ERR IN INCLUDING THE GAS MARKET DEMAND RULE IN INSTRUCTION 2 TO SPECIAL ISSUE 2 (Reply To Appellants' Point Of Error Two).

Third Reply Point of Error:

THE TRIAL COURT DID NOT ERR IN DEFINING THE TERM DELIVERABILITY USED IN INSTRUCTION 2 TO SPECIAL ISSUE 2 (Reply To Appellants' Points of Error Three and Four).

Fourth Reply Point of Error:

THE TRIAL COURT'S INSTRUCTIONS TO SPECIAL ISSUE TWO WERE ENTIRELY PROPER AND WERE NOT PREJUDICIAL COMMENTS ON THE WEIGHT OF THE EVIDENCE (Reply to Appellants' Point of Error Five).

Fifth Reply Point of Error:

THE TRIAL COURT DID NOT ERR IN CONDITIONALLY SUBMITTING SPECIAL ISSUE THREE (Reply to Appellants' Point of Error Six).

Sixth Reply Point of Error:

THE TRIAL COURT PROPERLY ENTERED JUDGMENT FOR VALERO ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY, BECAUSE THERE WAS SOME EVIDENCE TO SUPPORT THE JURY'S FINDING (Reply to Appellants' Point of Error Seven).

Seventh Reply Point of Error:

THE TRIAL COURT PROPERLY ENTERED JUDGMENT ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY BECAUSE THE EVIDENCE IN SUPPORT OF THAT FINDING WAS LEGALLY CORRECT AND FACTUALLY SUFFICIENT TO SUPPORT THE FINDING (Reply to Appellants' Point of Error Eight).

Eighth Reply Point of Error:

THE TRIAL COURT PROPERLY ENTERED JUDGMENT ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY BECAUSE THE FINDING WAS AMPLY SUPPORTED BY THE EVIDENCE, AND WAS NOT AGAINST THE GREAT WEIGHT AND PREPONDERANCE OF THE CREDIBLE EVIDENCE (Reply to Appellants' Point of Error Nine).

III. STATEMENT OF FACTS

A. *The Parties.*

Valero Transmission Company ("Valero"), Appellee, is a public utility intrastate gas pipeline company that purchases, transports, and sells natural gas throughout the State of Texas. Valero operates over 7,000 miles of pipeline, connected to over 13,000 wells. (S.F. 542, 677.) Valero's customers include gas distribution companies that service cities such as San Antonio, Austin, and Dallas, industrial consumers, and other pipeline companies. (S.F. 529-30.) Valero meets its customers' forecasted demands by acquiring natural gas from over 800 producers pursuant to approximately 2400 gas purchase contracts. (S.F. 542.)

Lively Exploration Company and the other appellants (collectively "Lively") are producers, operators, royalty interest owners, and sellers of oil and gas in Texas. (S.F. 105-07). It is uncontroverted that both Valero and Lively are at all times subject to the regulatory authority of the Railroad Commission of Texas ("Commission"). Tex. Rev. Civ. Stat. arts. 6050-53 (Vernon 1962 and Vernon Supp. 1987); Tex. Nat. Res. Code Ann. Sec. 81.051, 111.081 (Vernon 1978). (S.F. 419-23; 675, 1552, 1556.)

B. *The Contract.*

On February 12, 1973, Lively entered into a Gas Purchase Agreement ("Contract") (P. Ex. 1) with Valero's predecessor-in-interest for the sale of natural gas produced from Lively's properties in Sutton County, Texas. It is undisputed that at the time Lively and Valero entered into the Contract, demand for natural gas far outstripped supply, and neither Lively nor Valero foresaw that eventually the natural gas industry would suffer from a dramatic oversupply that would change the entire nature of the industry. (S.F. 147-48, 593-94.)

Lively and Valero included various provisions in the Contract relevant to this lawsuit. Among these provisions is a "take-or-pay" provision:

> *Subject to the other provisions hereof,* Buyer agrees to purchase and pay for (or, *if Buyer's performance hereunder is not excused by other provisions of this agreement,* pay for, *if available,* whether taken or not) during the days of each Contract year . . . a *Daily Contract Quantity* of gas from Seller's Lands and Leases in the Contract Area equal to ninety percent (90%) of Seller's daily *Deliverability* of gas hereunder.

(P. Ex. 1, p.12, Art V, § 5.3) (emphasis supplied).

The take-or-pay provision references two specific terms that are defined in the Contract and operate with the take-or-pay clause to set forth Valero's take-or-pay obligations: "Daily Contract Quantity" ("DCQ") and "Deliverability." The Contract defines "DCQ" as "the quantity of gas per day, averaged over each contract year, which Buyer is required to take from Seller hereunder at the point of delivery specified in this Agreement." (P. Ex. 1, p. 2, art. I[e].)

Since the Contract states that the DCQ is 90% of *Deliverability,* the extent of any take-or-pay obligation must be measured in accordance with the specific Contract definition of "Deliverability":

> [T]hat quantity of gas which Seller *has available for delivery* from the Lands and Leases to Buyer during each day, in conformity with the requirements of

> this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but *not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.* Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity in accordance with good engineering and gas production practice can be produced from Seller's wells in the field.

(P. Ex. 1, p. 3, art. I[j]) (emphasis supplied.)[1]

Thus, the take-or-pay provision in the Contract requires Valero to take, or pay for *if available,* 90% of the quantity of gas Lively has *available for delivery, not to exceed* the maximum production allowed by the Railroad Commission of Texas ("Commission").

The take-or-pay provision was included to reassure Lively that Valero would not discriminate against Lively by taking gas from a producer with a lower price to the exclusion of Lively, whose gas in the subject area was dedicated to the Contract.

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[1] Although in its Brief for Appellants, Lively argues that the Contract also contains another definition of "Deliverability," throughout trial the definition in art. I(j) was accepted as the proper one by ***both sides***. Lively in fact submitted ***only the definition*** in art. I(j) of "Deliverability" as an instruction in its proposed charge (Tr. 66, 73.)

The Contract also includes a "regulatory bodies" clause expressly making the Contract *subject to* Texas laws and the rules and regulations of an "authority having jurisdiction" such as the Commission:

> This Agreement is made *subject to* all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction.

(P. Ex. 1, p. 27, art. XIII, § 13.1.)

Additionally, the parties included a *force majeure* clause:

> If either party hereto is rendered unable, wholly or in part, by force majeure, or other causes herein specified, to carry out its obligations under this Agreement, other than any matured obligation to pay money, it is agreed that upon notice . . . then the obligations of the party giving such notice, so far as they are affected by such force majeure or other causes herein specified, shall be suspended during the continuance of any inability so caused. . . .
>
> * * *
>
> The term "force majeure" as employed herein includes without limitation by the following enumeration acts of God . . . *temporary failure of wells or sources of supply of gas, or market;* and any other causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension and which by the exercise of due diligence such party is unable, wholly or in part, to prevent or overcome. . . .

(P. Ex. 1, pp. 26-26A, art. XII, §§ 12.1,12.2.)

C. *Relevant Laws and Regulations.*

1. *The Regulated Nature of the Texas Oil and Gas Industry.*

The repeated deference in Contract provisions to Texas laws and Commission rules and regulations reflects the parties' recognition that the Commission regulates basically all facets of the drilling, production, transportation, and use of natural gas in Texas. (S.F. 419-23, 1474.)

The Commission's authority is accorded by the Texas Natural Resources Code ("Code"). The Code declares "waste" to be unlawful, and defines "waste" as *"the production of natural gas in excess of* transportation or market facilities, or *reasonable market demand* for the type of gas produced." Tex. Nat. Res. Code Ann. § 86.001-.012 (Vernon 1978) (emphasis supplied) (S.F. 1491). The Code charges the Commission with adopting "all necessary rules" to ensure production of natural gas in accordance with market demand and to prevent its *waste*. Code §§ 85.051, 85.052, 86.001, *et seq.*, 111.081, *et seq.* (Vernon 1978 and Vernon Supp. 1987) (emphasis supplied.)

The Commission also implements the Code's goal of "compelling *ratable* production," Code § 86.001, and carries out the Texas Common Purchaser Act's stipulation that a pipeline such as Valero must purchase gas without discrimination in favor of one producer or person against another producer or person in the same field and without unjust or unreasonable discrimination between fields in Texas. Code § 111.083 and § 111.086.

2. *The Gas Market Demand Rule Adopted in 1978.*

To discharge its Code-prescribed duties of conserving Texas' precious natural gas in an equitable manner, in

1978 the Commission adopted a system to "prorate" natural gas production — i.e., to determine the overall quantity of natural gas that should be produced in Texas in a given month and to assure that each producer is allowed to produce his fair share of that amount. (S.F. 1551.) The heart of this system, and one of the primary regulations with which Valero and Lively are required to comply, is known as the Gas Market Demand Rule. 16 Tex. Admin. Code § 3.91 ("§ 3.91") (prior to 9/1/86) and 16 Tex. Admin. Code § 3.30 ("§ 3.30") and § 3.34 ("§ 3.34") (from and after 9/1/86, as amended effective 3/2/87) ("Gas Market Demand Rule" or "Rule"). (D. Ex. 7; S.F. 1491-94.)[2]

Both Valero and Lively *agree* on what the Gas Market Demand Rule says and requires. At trial, Valero presented uncontroverted testimony by John Poerner ("Poerner"), a Railroad Commissioner when the Gas Market Demand Rule was adopted and subsequently chairman of the Commission, who thoroughly explained the Rule and its operation. (S.F. 1472-1556.)

As Poerner elucidated, the Rule's gravamen is twofold. First, it requires an intrastate pipeline company such as Valero: (i) *to limit its purchases* of gas from producers to proportionate shares of the pipeline's downstream market demand; (ii) *to allocate its purchases* "ratably" (without discrimination) among its various producers; and (iii) to purchase various categories of gas, established by the Commission, in a specified order of priority. 16 Tex. Admin. Code § 3.91 (prior to 9/1/86); (D. Ex. 7, 21; S.F. 324-25, 689, 693, 910, 989, 1007, 1050, 1494.)

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[2] The Gas Market Demand Rule as issued on January 16, 1978 was introduced into evidence as D, Ex. 7. Lively objected to evidence of amendments after the Contract years at issue, and the trial court excluded such evidence. Thus, all citations to sections of the Gas Market Demand Rule are to the sections as in effect during the Contract years at issue, and as reflected in D. Ex. 7.

Second, it proscribes a *producer* such as Lively from producing gas in excess of its ratable share of its purchaser's downstream market demand. (S.F. 935, 989, 1050, 1552, 1556.) The achievement of ratability *requires* participation by the producers, since producers, not pipelines, have physical control of the wells and the quantity of gas actually produced. (S.F. 715, 1344.)

To ensure that production and takes are in accordance with market demand, the Gas Market Demand Rule explicitly sets forth steps that producers and pipelines must follow each month. To summarize, early each month a pipeline's downstream customers give the pipeline "nominations" of their "firm forecast of . . . [their] actual demand." (D. Ex. 7, § .001(d)(2)(A); S.F. 683-84.) The pipeline then files its own nomination with the Commission reflecting the amount of gas it expects to take from each field. (S.F. 1318-19.) The pipeline must nominate an amount *equal to* the total quantity for which it is the ultimate consumer and the total quantity nominated by its downstream purchasers. (D. Ex. 7, § .001(d); S.F. 682-84.) In making its nominations, a pipeline must "ratably apportion" them from the fields from which it purchases and from the gas wells connected to its system. (D. Ex. 7, § .001(e).) A pipeline must also make its nominations according to the Commission's "priority system" of different categories of gas. *Id.* The priority system requires a pipeline to nominate, take, and exhaust all of a higher category of gas available from its producers before taking any gas in a lower category. (*Id.*, D. Ex. 20; S.F. 693, 1324-25.)[3]

The pipeline then tells its producers the amount it intends to nominate, so that they can forecast production. (S.F. 685-86, 1321.) The Commission adds up nominations of all pipelines taking gas from a given field, divides that number among the wells in a field and allocates an amount of production to each particular well. (S.F. 1499-1500.) This amount is the well's "full prorated allowable." (S.F. 1336, 1500.)

Because actual market demand may deviate from the amount projected by a pipeline in its nomination, each month a pipeline gives each of its producers a "rate of flow request" letting it know the pipeline's actual market demand, and how much gas the producer should tender to supply its ratable share of that market demand. (S.F. 686-87.) If the pipeline's demand is less than projected in its nomination, production from each well *must* be reduced ratably (proportionately), even though the well's "allowable" may be set at a higher amount. (S.F. 687.) Based on the procedures outlined in the

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[3] Specifically, under the 1978 Gas Market Demand Rule "casinghead gas" was given the highest priority, followed by gas classified as "Rule 49(b)" gas as second priority, and "special allowable" gas as third priority. (S.F. 591, 622, 689, 1494.) Valero must purchase all *priority* gas ("casinghead," then "Rule 49(b)," and then "special allowable" gas) dedicated to its system before it can purchase ***any*** ***non-priority*** gas (such as the prorated "gas well gas" produced by Lively.) (S.F. 693.)

The Commission established the priority categories based on sound public policy considerations. For example, in according casinghead gas highest priority the Commission was mindful of the Arab oil embargo, since curtailment of casinghead gas interrupts oil production. (S.F. 1494.)

Gas Market Demand Rule a pipeline then purchases gas without discrimination and in accordance with the priority categories. (S.F. 934.)

In summary, the overriding goal of Texas' complex and carefully drawn regulatory scheme governing the oil and gas industry is to ensure that production of natural gas does not exceed market demand and result in "waste" as that term is defined by statute, and that production of the market demand is fairly apportioned among producers. (S.F. 1491-93, 1499, 1551.)

D. *The Interface Between the Gas Market Demand Rule and the Contract.*

Pursuant to the *parties' own agreement* as reflected throughout the Contract, the take-or-pay provision and Gas Market Demand Rule work in tandem to define Valero's take-or-pay obligations. Both Valero's obligation to take and its alternative obligation to pay are limited *by the Contract's own terms* to the quantity Lively has "available for delivery," "not exceeding the maximum rate of flow permitted by [Commission rules and regulations]." The Gas Market Demand Rule governs the amount of gas Lively can have "available for delivery" at a given time, and establishes that the "maximum . . . rate of flow" under the Contract can never exceed Valero's downstream market demand.[4]

It is *uncontroverted* that Valero's downstream market demand has drastically declined. (S.F. 568, 571, 1040, 1483-84, 1532; D. Ex. 11A, 38, 64.) It was similarly conclusively demonstrated at trial (and Appellants do not argue otherwise in their Brief) that during the Contract years in issue Valero nominated and requested *all* of Lively's gas for which Valero had a downstream market demand. (S.F. 1349-51, 1376.)

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[4] It is worth noting that the Gas Market Demand Rule also established procedures preventing the discrimination the take-or-pay clause was originally included to discourage.

Any quantity exceeding the amount Valero actually took from Lively, therefore, could not be produced pursuant to Commission rules, and the Contract by its own terms did not require Valero either to take or to pay for that amount of gas.

E. *Lively's Lawsuit*

Despite the fact that Valero had clearly complied with the Contract's take-or-pay provisions, Lively sued Valero for purportedly breaching the take-or-pay clause for the Contract years 1982-1985. Valero therefore found itself in the ironic position of *defending* a breach of contract lawsuit despite its compliance with the plain terms of the Contract.

F. *The Trial.*

At trial, Lively called only three witnesses: Harry Lively, who testified about the Contract although he had not negotiated it (S.F. 149-50); Jimmy Condra, who testified as to the results of alleged "deliverability tests" on the wells even though he had not run the tests himself in the last five years (S.F. 660-61) and even though the pumper he claimed had run the tests testified that he had never run such tests (S.F. 952-53); and Max Powell, who testified as to alleged take-or-pay damages. (S.F. 367-403.)

Valero called a number of witnesses, including: John Poerner, who testified concerning the meaning and import of the Gas Market Demand Rule (S.F. 1447-1552); Frank J. Becraft, President of Valero, and Jeffrey H. Parish, Director of Proration and Producer Affairs of Valero, who testified as to the decline in Valero's downstream market and Valero's strict adherence to the Gas Market Demand Rule (S.F. 531-34, 565-73, 710, 713, 675-936, 1307-76); Travis B. Crow, Valero's Director of Reserve Evaluation, who testified about the unreliability of Lively's "deliverability" tests (S.F. 1191-1271); Dr. Alan Anderson, who testified about the decline in Valero's downstream markets; and several others.

The take-or-pay claims were submitted to the jury. In response to Special Issue No. 2, the jury answered "no" to the question, "Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity ("DCQ")?" (Tr. 145.) Thus, on May 4, 1987, the Honorable Judge Bob Parks properly entered a take-nothing judgment against Lively on its take-or-pay claim against Valero. (Tr. 158).

G. *The Appeal*

Lively has appealed the judgment as to its take-or-pay claim. The trial court's judgment is supported by both the law and the evidence, and should be sustained.

In its Brief for Appellants ("Lively's Brief"), Lively recognizes that it cannot undermine the jury's verdict or the trial court's judgment based on the Record or the applicable law. Therefore, in its Brief Lively grossly distorts the plain meaning of some Contract provisions and omits reference to others, completely mischaracterizes Valero's position, and wholly ignores the overwhelming evidence supporting the jury's findings, most of which Lively did not even attempt to controvert at trial. In desperation, Lively even complains on appeal of an instruction to the jury that *Lively* submitted.

That Lively cannot rely on the Record as it exists and the Contract as it is written exposes its recognition that an accurate characterization of the Contracts, the law, and the evidence compels affirmance of the trial court's judgment.

IV. THE RELEVANCE OF THE GAS MARKET DEMAND RULE

First Reply Point of Error (Restated):

THE TRIAL COURT DID NOT ERR IN ADMITTING EVIDENCE OF THE RAILROAD COMMISSION'S GAS MARKET DEMAND RULE OFFERED BY VALERO (Reply to Appellants' Point of Error One).

Second Reply Point of Error (Restated):

THE TRIAL COURT DID NOT ERR IN INCLUDING THE GAS MARKET DEMAND RULE IN INSTRUCTION 2 TO SPECIAL ISSUE 2 (Reply to Appellants' Point of Error Two).

A. *The Overall Fallacy in Lively's Argument.*

Lively's argument under its First and Second Points of Error embodies a gross mischaracterization of Valero's position at trial. Lively opens its argument by asserting:

> Valero seeks to avoid its obligations under [the take-or-pay] provision by asserting that the Railroad Commission gas market demand rule *abrogates* the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity of gas not taken. It is Appellants' position that as a matter of law the Railroad Commission gas market demand rule does not affect the rights and obligations of the parties to this Contract by relieving Valero of its obligations to pay for this minimum quantity of gas provided by the Contract.

(Appellants' Brief, p. 11) (emphasis supplied.)

Lively is purely and simply "setting up a straw man and knocking it down." Whether the Gas Market Demand Rule unilaterally *abrogates* the take-or-pay provision is *not the issue* in this appeal. In *this* Contract, the *quantity* of gas Valero is required to take *or pay for* is *defined* as an amount "available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission] rules." (P. Ex. 1, p. 3, art. I[j].)

As explained in § IIIB, *supra,* the take-or-pay provision requires Valero to take or pay for 90% of Seller's daily Deliverability. Deliverability is defined in the Contract as the "quantity of gas which Seller has *available for delivery . . . but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.*" Thus, the *Contract* itself states that Commission rules and regulations can limit Valero's obligation to take *and* its alternative obligation to pay. The Contract does not require Valero's *payment* for a minimum quantity of gas as measured in Mcfs or Btus; it requires payment for a certain *percentage* of "Deliverability," a defined term that embodies the concept that it is limited by Commission rules and regulations.

Lively's entire argument under its First and Second Points of Error, the *bulk* of its Brief, is therefore based on a faulty premise, in an attempt to divert this Court's attention from the plain words of the Contract. Whatever contract Lively's Brief discusses, it is not this one. In essence, through its lawsuit Lively sought to *rewrite* and engraft into the Contract a provision the parties did not include.

B. *Lively's Specific Arguments.*

Under its First and Second Points of Error, Lively initially discusses its irrelevant proposition that "[t]he gas market demand rule and associated ratable take requirements relate to the *production* and *taking* of gas. . . . They do not regulate the payment for gas not taken. . . ." (Lively's Brief, p. 11.) Lively cites an unpublished district court judgment in *Dallas Production Co. v. Railroad Commission*, No. 260,641 (District Court of Travis County, 53rd Judicial Dist. of Texas, June 10, 1977), in which the court stated that the Commission had exceeded its statutory authority by issuing an order that any provisions inconsistent with the Gas Market Demand Rule were "rendered inoperative," including "obligations requiring gas purchasers to take, or pay for if not taken, quantities greater than allowable set by this Commission."

To the extent that an unreported district court judgment could be considered by this Court, however, it is irrelevant, since the plain terms of the Contract limit *Deliverability* to the amount the Commission allows Lively to produce and Valero to take. Whether the Commission has the authority unilaterally to render take-or-pay provisions "inoperative" is an immaterial inquiry.

Lively next invokes the preamble to the most recent formulation of the Gas Market Demand Rule as adopted by the Commission in March of 1987, even though at trial Lively vigorously objected to evidence concerning the recent version. (S.F. 690.) The preamble states that recent amendments to the Gas Market Demand Rule "shall not affect existing contractual rights and obligations between parties." As shown, however, the Contract clearly defines Valero's obligations to take *or* pay as limited by the amount Lively can legally produce and Valero can legally take. The wording of the preamble is again irrelevant to Valero's purchase obligation under the language of the Contract.

Lively also cites several unpublished district court summary judgments purporting to undermine a gas market demand rule defense. Aside from the fact that these one-page conclusory judgments provide no precedent for this Court, they are predicated on different facts and different contracts.[5] The judgments contain no indication that the contracts at issue in those cases *specifically* limited the obligation to pay, as well as the obligation to take, to the maximum quantity of gas

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[5] In fact, the district court in this case *withdrew* a summary judgment (Tr. 29) and denied a second motion for summary judgment recognizing there were material fact issues ripe for jury consideration.

"available for delivery," "not exceeding" the amount Valero can legally take and Lively can legally produce.

Lively's next argument seems to be simply that the Contract is unfair, since "[u]nder Valero's contention, Valero's takes will always equal deliverability, and there can never be a deficiency under the take-or-pay provision of the Contract requiring Valero to pay for gas not taken." (Brief of Appellants, p. 15.) Lively goes on to argue that Valero thus "fails to recognize the purpose and effect of alternative performance obligations. . . ." (*Id.*)

Again, Lively's argument has no relevance to *this* Contract, in which *both* of *Valero's* alternative methods of performance are tied to the Contract's definition of "Deliverability." Lively cites cases it claims support its argument that an alternative obligation to pay is not relieved by an inability to take, but *none* of these cases involved contracts such as this one where Valero's alternative obligation to pay is *expressly* limited to payment for the quantity it can take. Lively itself concedes that an alternative obligation to pay could be excused by "some specific contract language so providing." (Lively's Brief, p. 18.) Such specific contract language exists in this case.

Finally, Lively asserts that "if the gas market demand rule has the effect asserted by Valero, the take-or-pay provision . . . becomes meaningless," and cites case authority holding that "parties to an instrument generally intend that every clause has some effect and purpose." (Lively's Brief, p. 19.) Lively adds that Valero's interpretation would "deprive Lively of the protection of that important provision." (*Id.*, p. 20.) First, the Gas Market Demand Rule was adopted *after* the Contract was signed (S.F. 113, 1517); the parties' intent as evidenced by the Contract was clearly to provide for a limitation on an obligation to pay for gas not "Deliverable" pursuant to applicable rules and regulations. It is *Lively* who seeks to deny effect and purpose to critical clauses of the Contract — the Deliverability definition and the take-or-pay clause considered in light of that definition. As Lively's cited authorities hold, this Court cannot change or engraft a new provision onto this Contract redefining "Deliverability."

Moreover, the Gas Market Demand Rule affords Lively the *exact* protection the take-or-pay provision was meant to afford — from discrimination in takes.

In truth, it is Lively's interpretation of the take-or-pay clause that is unfair and unreasonable. Lively characterizes the take-or-pay clause as a producer's *insurance policy* against any downturn in the market, even an unforseen downturn of dramatic proportions changing the nature of the industry. Under Lively's interpretation, it would be entitled to *payment* for gas that it cannot even deliver under applicable rules and regulations. Clearly, the parties did not intend that the pipeline should bear the entire brunt, with no adverse effects on the producer, of the type of decline currently existing in the natural gas market. Such an interpretation is not only egregiously unfair, it is incorrect under the plain terms of the Contracts.

As a final note, Lively conclusorily states that this Court's recent opinion in *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, No. 04-84-00499-CN (Tex. App. — San Antonio, May 13, 1987) (not yet reported), is inapplicable. In *Kodiak*, this Court affirmed a take-nothing judgment against a producer on a take-or-pay provision in a gas purchase contract. The Court held that the pipeline's obligation to take or pay for gas had been suspended by events of *force majeure* as defined in the contract. Because *Kodiak* undermines Lively's position completely, including its argument that alternative obligations to pay are not excused by an inability to take, Lively lamely seeks to distinguish *Kodiak*. First, Lively states that the jury in this case did not make a finding that Valero's performance was excused by virtue of the *force majeure* provision. The jury was given a copy of the Contract, however, and could well have concluded that *force majeure* precluded liability.

Lively also contends that the *force majeure* clause in *Kodiak* differs from that involved in the Contract here. In fact, the *force majeure* clauses are very similar, in that both specify failure of markets as a condition of *force majeure*. The evidence was uncontroverted at trial that Valero's market for Lively's gas had drastically failed, and that Valero had taken all the gas from Lively for which it had a downstream market demand. (S.F. 568, 571, 1040, 1483-84; D. Ex. 11A, 38, 64.) Thus, *Kodiak* is directly applicable. Moreover, another Texas court recently ruled that cessation of production when wells are shut in under Commission orders is an event of *force majeure*. *Frost National Bank v. Matthews,* 713 S.W. 2d 365 (Tex. App.—Texarkana 1986, writ ref'd n.r.e.) (*force majeure* clause prevented termination of lease). Thus, an inability to take can be *force majeure*.

C. *Conclusion.*

In conclusion, Lively's entire argument under its First and Second Points of Error fails to address the express provisions of the Contract, and thus underscores that the trial court's judgment should be affirmed.

V. THE INSTRUCTION ON "DELIVERABILITY"

Third Reply Point of Error (Restated):

THE TRIAL COURT DID NOT ERR IN DEFINING THE TERM DELIVERABILITY USED IN INSTRUCTION 2 TO SPECIAL ISSUE 2 (Reply to Appellants' Points of Error Three and Four).

The trial court properly defined the term "Deliverability" in its Instruction 2 under Special Issue No. 2. In fact, the definition submitted by the trial court was the exact definition *Lively* requested.

A. *Lively Failed to Preserve Any Alleged Error.*

In Appellants' Brief, *for the first time ever,* Lively complains of the trial court's instruction to the jury on the meaning of "Deliverability," an instruction Lively itself submitted. Lively contends that the trial court should have characterized language on Deliverability *testing* in the take-or-pay clause as a *definition* of "Deliverability," instead of employing the definition in the "Definitions" section of the Contract.

Lively has no standing to belatedly complain of this instruction on appeal. Lively submitted the *exact* definition of which it now complains! (Tr. 66, 73.) Lively never requested additional or substitute language on "deliverability" from Article V, § 5, nor did Lively at trial object to the definition as worded (presumably since it submitted it). (S.F. 1673-90, Tr. 66, 73.) Therefore, Lively's complaint of error is *waived.* Tex. R. Civ. P. 274;

State v. Harrington, 407 S.W.2d 467, 479 (Tex. 1966), *cert. denied,* 386 U.S. 944, 87 S. Ct. 977 (1967). *State v. Lackey,* 576 S.W.2d 685, 688-89 (Tex. Civ. App.—San Antonio 1979, writ ref'd n.r.e.); *Adam v. Harris,* 564 S.W.2d 152, 156 (Tex. Civ. App.—Houston [14th Dist.] 1978, writ ref'd n.r.e.); *Southwestern Bell Telephone Co. v. Ramsey,* 542 S.W.2d 466, 476 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.). A party cannot predicate error on instructions given at his own request. *McFadden Publications, Inc. v. Wilson,* 121 S.W.2d 430, 433 (Tex. Civ. App.—El Paso 1938, writ ref'd).

In its Brief, Lively disingeniously claims it "objected to the Trial Court's submission to the jury of Special Issue 2 and its accompanying instructions (S.F. 1675), thereby preserving error." (Appellant's Brief, p. 22). However, an objection to an instruction must be specific and distinct to preserve error for appeal. *Mahan Volkswagen, Inc. v. Hall,* 648 S.W.2d 324, 330 (Tex. App.—Houston [1st Dist.] 1982, writ ref'd n.r.e.); *Southwestern Bell Telephone Co.,* 542 S.W.2d at 476. Reference to S.F. 1675 discloses only a general objection to the submission of Special Issue No. 2 on the purported grounds that it was not a controlling issue, not on grounds that it contained an improper definition of deliverability. In fact, the Record discloses no such objection in the entirety of Lively's objections to the charge, presumably because Lively submitted the precise definition used. (S.F. 1673-90.)

B. *The Definition Was Proper.*

The trial court's instruction, moreover, was entirely proper. The *definition* of Deliverability is contained in the "Definitions" article of the Contract, Article I. The most logical construction of the Contract, and the one the trial court obviously adopted, is that the reference to Deliverability in the take-or-pay provision merely refers to a method for measuring physical deliverability; it is not the *definition* of Deliverability, and certainly does not *supplant* the language in the Deliverability definition that Deliverability in no event exceeds the maximum legal production.

Last, Lively argues that the explanatory instruction on Deliverability required the answer to a question of law—whether the Gas Market Demand Rule modified existing contractual relationships between private parties. As noted, *Lively* submitted the instruction, which in any event does not require the jury to answer a question of law. It rather provides the jury with necessary background to determine the fact question of whether Valero failed to take the DCQ under the Contract, in light of Valero's evidence on its market demand for Lively's gas and the effect of the Rule.

Therefore, the instruction on Deliverability was entirely proper, and clearly did not cause the rendition of an improper judgment.

VI. THE TRIAL COURT'S OTHER INSTRUCTIONS TO SPECIAL ISSUE NO. 2

Fourth Reply Point of Error (Restated):

THE TRIAL COURT'S INSTRUCTIONS TO SPECIAL ISSUE 2 WERE ENTIRELY PROPER AND WERE NOT PREJUDICIAL COMMENTS ON THE WEIGHT OF THE EVIDENCE (Reply to Appellants' Point of Error Five).

In its Fifth Point of Error Lively cavils with several specific Instructions given under Special Issue No. 2. All of these instructions were proper, and could not have caused the rendition of an improper judgment.

A. *Instructions Relating to Waste.*

First, Lively complains that the following Instructions constituted "prejudicial comments on the weight of the evidence":

> The term "market demand" means that amount of gas needed for current consumption.
>
> You are instructed that the production, transportation, or use of gas in a manner, in an amount, or under conditions which constitute waste is unlawful and is prohibited.
>
> You are instructed that the term "waste" includes the production of gas in excess of transportation or market facilities or reasonable market demand for the type of gas produced.

(Tr. 200.)

These Instructions mirror language in the Texas Natural Resources Code and *Railroad Commission v. Woods Exploration & Producing Co.*, 405 S.W.2d 313, 318 (Tex. 1966), and were entirely proper. First, they were directly relevant to whether Valero had failed to take the DCQ under the Contract. As explained, DCQ is a function of *Deliverability*, which is the amount of gas "available for delivery," not exceeding maximum legal production. The jury was presented evidence on the absence of Valero's market demand for Lively's gas. (S.F. 531-34, 540, 565-71, 602, 1040, 1332.) These Instructions enabled the jury to place this evidence in the context of applicable rules and regulations, and thus in the context of the Deliverability clause.

Moreover, Lively does not explain how these Instructions, even if irrelevant, "nudged" the jury against Lively. Lively implicitly concedes that these Instructions are correct statements of the law. In truth, Lively's objection to these Instructions is based on the same faulty premise pervading its Brief: that the issue in this case is whether the conservation statutes and Commission rules unilaterally abrogate the take-or-pay provisions. Lively asserts: "There are no conservation statutes prohibiting Valero from paying even when it cannot take the gas." (Brief, p. 25.) The point, however, is that the *Contract* limits Valero's obligation to pay to payment for gas it can legally take. It cannot legally take gas in excess of its downstream market demand, because production of such gas would be "waste." Thus, these Instructions are directly relevant and cannot constitute harmful error. *See First State Bank & Trust Co. of Edinburg v. George*, 519 S.W.2d 198, 207 (Tex. Civ. App. — Corpus Christi 1974, writ ref'd n.r.e.).

A comment on the weight of the evidence occurs only when the judge assumes the truth of a material controverted fact, or exaggerates, minimizes, or withdraws some pertinent evidence from the jury's consideration. *Hirdler v. Boyd,* 702 S.W.2d 727, 729-30 (Tex. App. — San Antonio 1986, writ ref'd n.r.e.). In deciding whether an instruction constitutes an impermissible comment on the weight of the evidence, the Court must consider the charge as a whole. *Id.* at 730. To form a ground for reversal, a comment must be one that would probably cause the rendition of an improper judgment. *Id.* The Court may incidentally comment when necessary or proper as part of an explanatory instruction or definition. *Id.* Statutory duties *should* be handled by instruction. *See Southern Pacific Co. v. Castro,* 493 S.W.2d 491 (Tex. 1973). Under these standards, this Court could not have committed reversible error submitting Instructions that are correct statements of the law.

Again, Lively's complaint is a red herring to avoid the real issue: that wasteful takes are prohibited by Texas law and the Gas Market Demand Rule, and therefore that the definition of Deliverability does not require Valero to take or pay for *quantities* of gas that would be "wasteful" if produced.

B. *The Instruction Relating to Article V, ¶ 5.2.*

Lively also complains that the following instruction, which tracked Article V, ¶ 5.2 of the Contract, constituted an impermissible comment on the weight of the evidence:

> You are instructed that the Contract provides that subject to its other provisions, Valero shall have the right to purchase such quantity of gas per day as Valero may from time to time elect to purchase up to the total quantity per day which the wells are capable of producing when produced at their respective maximum efficient rates of flow, in Lively's sole judgment reasonably exercised, or at their respective allowable rates of flow under applicable orders, rules, regulations or laws, whichever is the lesser rate of flow.

(Tr. 199.)

Lively claims that this Instruction was prejudicial because it somehow implied that Valero controls the quantity of gas it is required to take or pay for.

This provision simply means what it says, and makes no additional implication. The jury was given the entire Contract; an Instruction as to one of its terms clearly was not prejudicial error causing an improper judgment. It is relevant to Special Issue No. 2 because it shows the parties' intention that Valero be bound by applicable regulations and laws.

VII. THE CONDITIONAL SUBMISSION OF SPECIAL ISSUE NO. 3

Fifth Reply Point of Error (Restated):

THE TRIAL COURT DID NOT ERR IN CONDITIONALLY SUBMITTING SPECIAL ISSUE THREE (Reply to Appellants' Point of Error Six).

Lively contends that the Court erred in conditionally submitting Special Issue No. 3. Lively argues that each party is entitled to have submitted the controlling issues for each ground of recovery or defense, that Special Issue No. 3 was a controlling issue, and that because the jury answered "No" to Special Issue "No. 2," conditional submission deprived Lively of a chance for the jury to answer the controlling issue.

Special Issue No. 2 inquired:

> Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)?

(Tr. 145.)

Special Issue No. 3 inquired:

> What sum of money, if any, if paid now in cash, do you find to be due and owing to Lively under the Contract?

(Tr. 147.)

Both Special Issue No. 2 and Special Issue No. 3 were accompanied by various Instructions.

Lively's argument is meritless. The central issue of its take-or-pay claim was whether Valero failed to take or pay for the Daily Contract Quantity of gas. Lively's own Brief *sums up* its claim against Valero as follows:

> Lively alleged that Valero breached its obligations under the contract *by failing to take delivery of and pay for the Daily Contract Quantity of natural gas* during certain contract years *or pay for such Daily Contract Quantity of natural gas whether taken or not.*

(Brief, p. 2) (emphasis supplied.) Special Issue No. 2 made this controlling inquiry. Special Issue No. 3 merely inquired as to the amount of damages in the event the jury answered Special Issue No. 2 in the affirmative.

In its own Brief, Lively describes a "controlling issue" as an "ultimate issue," as distinguished from a "evidentiary issue" which "tend[s] only to establish the fact of the controlling issue." (Lively's Brief, p. 28.) Special Issue No. 2 clearly did not merely "tend to establish the fact of the controlling issue," it *was* the controlling issue determining dispositively that Varelo had no liability under the take-or-pay provisions of the Contract.

To argue that "Lively's entire take or pay cause of action was submitted conditionally" is simply absurd.

(Lively's Brief, p. 29.) Surely Lively would not argue that, once the jury had determined Special Issue No. 2 in the negative, there were any further inquiries necessary on the take-or-pay claim. The conditional submission of Special Issue No. 3 was proper, and could not have caused the rendition of an improper judgment.

Since Lively's argument does not make sense, it is not surprising that no Texas cases support its position. Lively cites no authority holding that if a dispositive issue is answered in the negative, a plaintiff is entitled nonetheless to have additional issues answered that the negative answer render immaterial to the Court in entering Judgment.

VIII. THE OVERWHELMING EVIDENTIARY SUPPORT FOR THE JURY'S FINDING AND THE JUDGMENT

Sixth Reply Point of Error (Restated):

THE TRIAL COURT PROPERLY ENTERED JUDGMENT FOR VALERO ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY, BECAUSE THERE WAS SOME EVIDENCE TO SUPPORT THE JURY'S FINDING (Reply to Appellants' Point of Error Seven).

Seventh Reply Point of Error (Restated):

THE TRIAL COURT PROPERLY ENTERED JUDGMENT ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY BECAUSE THE EVIDENCE IN SUPPORT OF THAT FINDING WAS LEGALLY CORRECT AND FACTUALLY SUFFICIENT TO SUPPORT THE FINDING (Reply to Appellants' Point of Error Eight).

Eighth Reply Point of Error (Restated):

THE TRIAL COURT PROPERLY ENTERED JUDGMENT ON THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY BECAUSE THE FINDING WAS AMPLY SUPPORTED BY THE EVIDENCE, AND WAS NOT AGAINST THE GREAT WEIGHT AND PREPONDERANCE OF THE CREDIBLE EVIDENCE (Reply to Appellants' Point of Error Nine).

Lively's Points of Error Seven through Nine each involve the evidentiary support for the jury's answer to Special Issue No. 2.

Lively contends: (1) there was no evidence to support the jury's answer to Special Issue No. 2; (2) there was insufficient evidence to support the jury's answer to Special Issue No. 2; and (3) the jury's answer to Special Issue No. 2 was against the great weight and preponderance of the evidence.

The evidence supporting the jury's answer to Special Issue No. 2 is not only sufficient, it is overwhelming, and compels affirmance of the trial court's judgment.

A. *The Standard of Review.*

1. *"No Evidence" or "Legal Insufficiency" Points of Error.*

In reviewing "legal insufficiency" or "no evidence" points, the Court must consider only that evidence and reasonable inferences drawn therefrom in their most favorable light to support the jury's findings, rejecting all contrary or conflicting evidence and inferences. *King v. Bauer,* 688 S.W.2d 845, 846 (Tex. 1985); *Glover v.*

Texas General Indemnity Co., 619 S.W.2d 400, 401 (Tex. 1981); *Ray v. Farmers State Bank of Hart*, 576 S.W.2d 607, 609 (Tex. 1979); *Alterman v. Frost National Bank of San Antonio*, 675 S.W.2d 619, 620 (Tex. App.—San Antonio 1984, no writ). A "no evidence" point will not be sustained if there is *any* probative evidence to support the jury's finding. *Ray*, 576 S.W.2d at 609.

2. *"Factual Insufficiency" and "Great Weight and Preponderance" Points of Error.*

In passing on a complaint of insufficient evidence, a court must consider all the evidence and reverse only if the jury's decision is so clearly against the great weight and preponderance of the evidence as to render the judgment clearly wrong and manifestly unjust. *Pool v. Ford Motor Co.*, 715 S.W.2d 629, 634-35 (Tex. 1986); *In Re King's Estate*, 150 Tex. 662, 244 S.W.2d 660, 661 (1951); *Alterman*, 675 S.W.2d at 621.

An appellate court may not substitute its opinion for the jury's merely because it might have reached a different fact conclusion. *Thompson v. Wooten*, 650 S.W.2d 499, 501 (Tex. App.—Houston [14th Dist.] 1983, writ ref'd n.r.e.). Nor may an appellate court pass on the credibility of witnesses or the weight to be given their testimony. *Rego v. Brannon*, 682 S.W.2d 677, 680 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.).

B. *The Evidence in the Record.*

The evidence supporting the jury's answer to Special Issue No. 2 is in fact essentially uncontroverted. First, the Record demonstrates that Valero purchased from

Lively all the gas Lively could legally produce during the Contract years at issue, and thus purchased the DCQ as defined in the Contract. Second, Lively's own "evidence" glaringly failed to prove its case, even under Lively's erroneous theory that G-10 tests should determine deliverability instead of the express Contract definition.

1. *The Evidence Showed that Valero Took and Paid For the Daily Contract Quantity.*

As thoroughly explained in Section IIIB, *supra,* the Contract requires Valero to take or pay for 90% of the "quantity of gas [Lively] has available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission regulations]." At trial Valero presented extensive testimony proving it had taken the DCQ under the Contract. Lively's Brief does not refute this evidence, nor did Lively succeed in controverting it at trial.

(a) *The Meaning of the Gas Market Demand Rule.*

Because the Contract does not obligate Valero to take or pay for gas not legally deliverable under the Gas Market Demand Rule, Valero introduced the 1978 Gas Market Demand Rule and offered *undisputed* testimony from former Commission Chairman Poerner and Parish, Valero's Director of Proration and Producer Affairs, concerning the Rule's adoption and meaning. (S.F. 1472-1557; 675-699; D. Ex. 7.) The substance of their testimony is set forth in Section IIIC, *supra.* To briefly reiterate, the Rule: (i) requires Valero to purchase only a proportionate share of a producer's downstream market demand, to allocate its purchases "ratably" among its producers, and to purchase various defined categories of gas in a specified order of priority; and (ii) proscribes Lively from producing more gas than its ratable share, in accordance with the priority categories, of its purchaser's downstream market demand. (D. Ex. 7, 20-21; S.F. 324-25, 689, 693, 710, 910, 935, 989, 1007, 1050, 1494, 1552, 1556.)

(b) *Valero's Compliance with the Gas Market Demand Rule.*

Valero then showed that it had purchased from Lively the maximum quantity under the Rule, and thus took the DCQ as defined in the Contract.

(i) *Valero's Downstream Market Demand Has Dramatically Declined.*

First, Valero established through *unrebutted* evidence that its downstream market demand had declined to a point where it had been forced to drastically curtail purchases from its producers, including Lively.

Alan Anderson ("Anderson"), a specialist in natural gas economics with a Ph.D. in economic history from Johns Hopkins, and Valero's President, Becraft, explained at trial that a natural gas "market" is a function of *price*. (S.F. 533, 554, 1005.) The Commission requires Valero to charge an *inflexible* price for its gas equal to the weighted average of gas ("WACOG") plus $0.15. (S.F. 555, 571; D. Ex. 12.)[6] Over the past few years Valero's WACOG plus $0.15 has equalled $4.00 to $4.20

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[6] This requirement is contained in the Final Order in Gas Utilities Docket No. 500 dated September 4, 1979 ("Final Order") (D. Ex. 12; S.F. 556-59). The Appendix to the Final Order describes in great detail the WACOG calculation. (*See also* S.F. 570-71.)

per MMBtu of natural gas. (S.F. 555.) Therefore, Valero's sales market is the market for $4.00 gas. (*Id.*)

That market is currently virtually nonexistent. Due to many factors, including a reduction in industrial consumption and governmental policies adversely impacting demand, a natural gas glut arose approximately in 1981. (S.F. 602, 710, 713, 1040, 1495, 1483-84; D. Ex. 11A, 13A, 38, 94.) Prices for natural gas have fallen accordingly, currently to $1.50 per MMBtu. (S.F. 537.) Thus, Valero's customers can purchase gas, or use alternative fuels, at significantly lower prices than the $4.00 and above that Valero is required to charge them. (S.F. 529-34, 1012; D. Ex. 32.) As customers' contracts with Valero have expired, they have sought cheaper fuel elsewhere. (S.F. 529-34.) Valero's market has been drastically reduced. (S.F. 540, 568; 1040, 1532; D. Ex. 11A, 13A, 38, 64.) Its sales have declined from 620 billion cubic feet of gas in 1981 to 70 billion in 1986. (S.F. 540.) At the same time, its WACOG, including cost of service, has *increased.* (S.F. 571; D. Ex. 11A, 13A.)

The downstream market demand for $4.00 gas, which is Valero's market as established by the Commission, is purely and simply drying up. (S.F. 540, 568, 1040, 1532; D. Ex. 11A, 13A, 38, 94.)

(ii) *Valero's Nominations from Lively and its Other Producers Are in Accordance with its Downstream Market Demand.*

It is undisputed that *Valero has taken all of the gas available to it from Lively consistent with Valero's downstream market demand.* (S.F. 684.)

Parish explained that Valero scrupulously follows the procedures required by the Rule and set forth in § IIIC (2), *supra*. In fact, Valero has implemented a computerized system to mathematically apportion Valero's gas purchase requests ratably among its producers across its system, and in accordance with the priority categories. (*Id.*) (S.F. 676-78, 682-85, 695-99, 1307, 1310-11, 1318-21; D. Ex. 16, 17, 18, 19, 61, 62.)

Valero introduced numerous exhibits, explained by Parish, demonstrating systemwide ratability in accordance with the priority categories. (D. Ex. 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 74; S.F. 684, 1329-32, 1346-53, 1376.) In sum, his exhibits demonstrated that during the Contract years in issue Valero has been ratable in its nominations and rate requests required by the Gas Market Demand Rule. (S.F. 1376.)

Valero's purchases from Lively have been reduced to virtually zero because Lively produces primarily gas well gas (S.F. 209, 693), non-priority gas, and Valero's market demand has dropped *below* the amount of *priority* gas deliverability. (D. Ex. 63, 64; S.F. 1328-31.) Thus, Valero must satisfy its market demand exclusively through ratable purchases from producers of higher-priority gas. (S.F. 1324-25.) *Valero's nominations have been ratable among the non-priority gas producers.* (S.F. 1332; D. Ex. 64.)

In sum, Valero's uncontroverted evidence showed that it has taken all the gas from Lively "available for delivery," "not exceeding the maximum . . . [production] . . . permitted by [Commission] regulations." Therefore, Valero took and paid for the DCQ under the Contract, and the jury so found.

POINT 4. The Court of Appeals erred in holding that the obligations of Valero under the take-or-pay provision of the contract are controlled by the definitions of "Daily Contract Quantity" and "Deliverability" set forth in Article I of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 1, Appellants' Motion for Rehearing.]

POINT 5. The Court of Appeals erred in holding that the Trial Court properly submitted to the jury Special Issue No. 2 and Instruction No. 2 containing the definition of "Deliverability" from Article I(j) of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 9, Appellants' Motion for Rehearing.]

POINT 6. The Court of Appeals erred in holding that Lively waived their objection to Special Issue No. 2 and Instruction No. 2 containing the definition of "Deliverability" from Article I(j) of the contract.

[Germane to: Special Issue No. 2 (Tr. 145-146); Point of Error 10, Appellants' Motion for Rehearing.]

POINT 7. The Court of Appeals erred in holding that the instructions to Special Issue No. 2 were relevant, were not a comment on the weight of the evidence, and did not cause the rendition of an improper judgment.

[Germane to: Special Issue No. 2 (Tr. 145-146); Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Points of Error 11 and 12, Appellants' Motion for Rehearing.]

POINT 8. The Court of Appeals erred in holding that the Trial Court fairly submitted Special Issue No. 2, which was the controlling issue, and properly conditionally submitted Special Issue No. 3, which was the damage issue.

[Germane to: Special Issues No. 2 and 3 (Tr. 145-147); Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Point of Error 15, Appellants' Motion for Rehearing.]

POINT 9. The Court of Appeals erred in holding that Lively conceded that the evidence of the Gas Market Demand Rule supports the jury finding in Special Issue No. 2.

[Germane to: Point of Error 17, Appellants' Motion for Rehearing.]

Point 10. The Court of Appeals erred in holding that there was evidence to support the jury's finding on take-or-pay liability.

[Germane to: Plaintiffs' Motion for Judgment and Partial New Trial, ¶ 7 (Tr. 160-163); Point of Error 18, Appellants' Motion for Rehearing.]

POINT 11. The Court of Appeals erred in holding that legally incorrect evidence can be relied upon to support the jury's finding on take-or-pay liability.

[Germane to: Point of Error 19, Appellants' Motion for Rehearing.]

POINT 12. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals is pre-empted by the Natural Gas Policy Act.

[Germane to: Point of Error 23, Appellants' Motion for Rehearing.]

POINT 13. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals violates the Commerce Clause of the United States Constitution.

[Germane to: Point of Error 24, Appellants' Motion for Rehearing.]

FACT STATEMENT

This is a general fact statement germane to all points.

The contract in question (P. Ex. 1, S.F. 115) was entered into in 1973 between Lively and Valero's predecessor, Lo-Vaca Gathering Company. It grants to Valero the exclusive right and the obligation to purchase all of Lively's gas from the Contract Area for a period of 20 years.

The contract provides that Valero will, for each Contract Year, either (1) take delivery of and pay for the Daily Contract Quantity of natural gas or (2) pay for the Daily Contract Quantity of natural gas, whether taken or not. The Daily Contract Quantity is defined as a quantity of gas equal to ninety percent (90%) of Lively's daily deliverability of gas averaged over the Contract Year. The quantity of gas to be purchased by Valero taken or not. The Daily Contract Quantity is defined as a each Contract Year is determined by multiplying the Daily Contract Quantity by the number of days during the Contract Year during which Valero's performance was not excused by the contract.

Article V, ¶ 5.3, of the contract provides in pertinent part as follows:

> Subject to the other provisions hereof, Buyer agrees to purchase and pay for (*or*, if Buyer's performance hereunder is not excused by other provisions of this Agreement, *pay for, if available, whether taken or not*) during the days of each contract year of the term hereof *a Daily Contract Quantity of gas from Sellers' Lands and Leases in the Contract Area equal to ninety percent (90%) of Sellers' daily Deliverability of gas hereunder.* Upon request by Buyer or Seller, *Sellers' Deliverability shall be determined and established by Buyer by testing the actual ability of Sellers' wells to deliver into Buyer's facilities at the points of delivery;* provided, however, neither Seller nor Buyer shall request such Deliverability test more often than once in any ninety (90) day period. Such Deliverability tests shall be made after a stabilized rate of flow has been achieved against such pressure as is required to deliver into Buyer's facilities at the operating pressure at the points of delivery at the time of the test. . . .[2]

This provision in the contract is commonly known in the oil and gas industry as a "take or pay" clause. Mr. Lively testified that he would not have executed the contract if this provision had not been included (S.F. 121).

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[2] Emphasis added throughout except where indicated otherwise.

The contract also contains a general definition of the term "deliverability" which differs from the specific use of that term in the take-or-pay provision quoted above. Article I(j) of the contract defines the term "deliverability" as:

> [T]hat quantity of gas which Seller has available for delivery from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction. Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects to take hereunder up to the maximum quantity which in accordance with good engineering and gas production practice can be produced from Seller's wells in the fields.

Beginning with the 1982 Contract Year (June 1, 1982–May 31, 1983), and continuing through the 1985 Contract Year, Valero failed to either take and pay or simply pay for the minimum quantity of gas as required by the contract.

Pursuant to Article VIII, ¶ 8.2, of the contract, Lively calculated the amount due from Valero under the take-or-pay provision to be $21,264,689.30 (P. Ex. 51; S.F. 398).

Article VIII, ¶ 8.2, provides:

> If Buyer shall fail in any contract year of the term hereof to take the quantity of gas that Buyer is obligated to take hereunder, then Seller shall, within sixty (60) days after such contract year render a bill to Buyer based upon the weighted average price, including tax reimbursement, in effect hereunder during the contract year in which such deficiency occurred, computed on the volumes delivered during the year and at the price, including tax reimbursement, applicable to such volumes at the time of delivery thereof. If Buyer agrees with such statement, Buyer will make payment to Seller for the amount of such statement within sixty (60) days after receiving Seller's statement. In computing the amount due Seller for any deficiency in takes by Buyer occurring during any contract year, there shall be deducted from such deficiencies the following quantities:
>
> (a) The total of the quantities which Buyer requested, up to 111% of the Daily Contract Quantity, and which Seller failed to deliver for any reason on any day or days during such contract year; and,
>
> (b) The total of the quantities of gas which Buyer was unable to take or failed to take on any day or days during such contract year by reason of force majeure; and,
>
> (c) The total of the quantities of gas by which there was a deficiency in Seller's allowable for the wells covered hereby below the Daily Contract Quantity on any day or days during such year, excluding any portion of such deficiency which is caused by, or is a result of, Buyer's failure to nominate to the Texas Railroad Commission to purchase a quantity of gas equal to the Daily Contract Quantity; and

> (d) The total of the quantities of gas which Buyer refuses to take on any day or days during such year by reason of Seller's failure to meet any of the quality specifications or pressure requirements provided hereunder.

In asserting that it had no liability to Lively under the take-or-pay provision of the contract, Valero relied upon evidence that it took the amount of gas under the contract that it was authorized to take under the Gas Market Demand Rule of the Railroad Commission of Texas (S.F. 675-699, 1306-1377; D. Exs. 7, 78, 91; Tr. 45-50). The amount of gas Valero took under its contract with Lively was determined by Valero's market demand for gas as reflected in its monthly nominations for gas filed by Valero with the Railroad Commission (D. Exs. 62-62M).

The Trial Court submitted Lively's take-or-pay claim by way of two special issues to the jury. Special Issue No. 2 inquired whether "Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity (DCQ)" (Tr.145). Special Issue No. 3, concerning the amount of money that Valero owed to Lively for its failure to take or pay under the contract, was conditionally submitted by the Trial Court upon an affirmative finding being made by the jury to Special Issue No. 2 (Tr. 147). Since the jury answered Special Issue No. 2 in the negative, it did not answer Special Issue No. 3. On the basis of the jury's answer to Special Issue No. 2, the Trial Court entered judgment against Lively on its take-or-pay claim. Other special issues were submitted to the jury, and the part of the judgment incorporating the jury's findings on them was not appealed.

The Court of Appeals, in affirming the Trial Court's judgment, relied upon the general definition of "Deliverability" contained in Article I(j) of the contract and upon the government regulation clause in Article XIII, ¶ 13.1, making the agreement "subject to all valid applicable federal and state laws . . . and to the orders, rules and regulations of any federal or state regulatory body or authority having jurisdiction." (Court of Appeals' Opinion, pp. 3-4).

Plaintiffs' Exhibits 38-41 vividly show how Valero has manipulated its nominations of, and requests for, gas by comparing the quantities requested by Valero with the Daily Contract Quantities under the contract. During the period June 1, 1982 - May 31, 1986, the quantities requested by Valero were progressively reduced. During the 1985 Contract Year, the quantities requested by Valero averaged less than 1000 Mcf per day for 4 months and were virtually zero for 6 months, while the Daily Contract Quantity for that same period was 7080 Mcf per day.

SUMMARY OF ARGUMENT

This case should be reversed and judgment rendered that Valero is liable to Lively for its failure to pay for the Daily Contract Quantity under the contract for the Contract Years 1982, 1983, 1984, and 1985, and the case should be remanded for a new trial as to the amount owed to Lively by Valero.

The Trial Court and the Court of Appeals erred in failing to hold as a matter of law that Valero is not relieved of liability under the take-or-pay provision of the contract by the application of the Texas Gas Market

Demand Rule and in permitting the jury to pass upon this legal question. In so doing, the Court of Appeals ignored established rules of construction of contracts and in effect read out of the contract the important take-or-pay provision.

The courts below also erred in submitting, or approving the submission of, instructions to the jury in connection with Special Issue No. 2 which contained an improper definition of "Deliverability" for use in determining take-or-pay liability and were improper comments on the weight of the evidence which caused the rendition of an improper judgment. Error was committed in submitting Special Issue No. 2, which was not the controlling issue, and in conditionally submitting Special Issue No. 3, the controlling issue. Further, there was no evidence to support the jury's finding on take-or-pay liability, since the only evidence was legally incorrect.

The Court of Appeals' application of the Gas Market Demand Rule is invalid, because the Rule as applied by the Court is pre-empted by the Natural Gas Policy Act and violates the Commerce Clause of the United States Constitution.

ARGUMENT AND AUTHORITIES

POINTS OF ERROR 1-4. IN SUMMARY: THE COURT OF APPEALS ERRED IN HOLDING THAT THE TEXAS GAS MARKET DEMAND RULE APPLIED SO AS TO RELIEVE VALERO OF ANY TAKE-OR-PAY LIABILITY UNDER THE CONTRACT.

The effect of the judgment and the Court of Appeals' opinion is to hold that because of the Texas Gas Market

Demand Rule Valero has no liability to Lively under the take-or-pay provision of the contract. This is contrary to the clear and unambiguous provisions of the contract and the applicable rules of construction and has the effect of reading the take-or-pay provision out of the contract.

This is the first time a Texas court has made such a holding, and its ramifications are for reaching and will have a severe, adverse effect on gas producers in this state.

Article V, ¶ 5.3, of the contract contains the take-or-pay provision relied upon by Lively in this case. Valero seeks to avoid its obligations under that provision by asserting that the Railroad Commission Gas Market Demand Rule abrogates the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity when not taken. It is Petitioners' position that as a matter of law the Gas Market Demand Rule does not affect the rights and obligations of the parties to this contract by relieving Valero of its obligation to pay for the minimum quantity of gas provided by the contract.

Take-or-pay provisions have been recognized as standard provisions in gas purchase agreements since the early 1950's. 4 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 724.5 (1983). Courts have consistently held that such provisions are common in the industry and are not unconscionable or unfair. *Universal Resources Corp. v. Panhandle Eastern Pipeline Co.*, 813 F.2d 77 (5th Cir. 1987). The purpose of such clauses is to apportion the risks of natural gas production and sales between the seller and buyer. "The seller bears the risk of production.

To compensate seller for that risk, buyer agrees to take, *or pay for if not taken,* a minimum quantity of gas." *Universal Resources,* 813 F.2d at 80.

The Gas Market Demand Rule clearly does not relieve Valero of its alternative obligation to pay for the Daily Contract Quantity of gas as required by the take-or-pay provision of the contract. That rule and the associated ratable-take requirements relate to the *production* and *taking* of gas to prevent waste and protect correlative rights. They do not regulate the *payment* for as not taken under take-or-pay provisions of natural gas contracts. *Resources Investment Corp. v. Enron Corp.,* 669 F.Supp. 1038 (D. Colo. 1987). No Texas statute or Railroad Commission regulation, either expressly or by implication, prohibits or excuses a purchaser from *paying for* the quantity of gas for which that purchaser has contractually obligated itself to pay. Valero itself recognizes that there is nothing in the Gas Market Demand Rule that prevents Valero from paying for a deficiency when it exists by operation of the take-or-pay provision (S.F. 840).

The Railroad Commission and the courts have recognized that contractural obligations to pay for gas not taken are not superseded by the Gas Market Demand Rule.

An attempt by the Railroad Commission to declare by regulation that the Gas Market Demand Rule relieved purchasers of contractual take-or-pay obligations was held invalid almost immediately after its adoption. On February 22, 1977, the Railroad Commission issued an interpretive order relating to the Gas Market Demand Rule, in which the Commission attempted to declare that take-

or-pay provisions were invalid to the extent they contravened the provisions of that order. What has become known as the "penultimate paragraph" read as follows:

> IT IS FURTHER ORDERED that the provisions of any and all purchase or other agreements between producers and gas purchasers which contravene or are inconsistent with the provisions of this Order and [sic] are rendered inoperative, including, without limitation, provisions relative to (1) gas purchasers nominating to take gas in certain amounts or at certain levels, (2) producers asserting penalties, damages or other remedies against gas purchasers in the event of reductions in or cancellation of allowables and (3) *obligations requiring gas purchasers to take, or pay for it not taken, quantities greater than allowables set by this Commission.*

Railroad Commission Gas Well Allowable Order, 2 TEX. REG. 785, 788 (1977).

Three lawsuits were filed in the Travis County district courts challenging the validity of that order. In one of those cases, *Dallas Production Co. v. Railroad Commission*, No. 260,641 (Dist. Ct. of Travis County, 53rd Judicial District of Texas, June 10, 1977), the plaintiff asserted that the above-quoted paragraph was invalid because the Railroad Commission had exceeded its statutory authority by attempting to regulate take-or-pay contracts.[3] The Court held that the order was unlawful, invalid, and of no force and effect, stating:

> The Court further finds that the above quoted penultimate paragraph herein declared invalid does not affect the rights, duties or obligations of Brazos

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[3] Appendix at A1-A2.

> Electric Power Cooperative, Inc. and Brazos Fuel Company, Inc., Intervenors, and Plaintiff producers under the take or pay provisions of their gas purchase agreements.

The Railroad Commission did not appeal this judgment and subsequently repromulgated the order without the invalid paragraph, and it became regularly adopted as what is commonly referred to as the Gas Market Demand Rule. 3 TEX. REG. 324 (1978). That rule, with minor revisions, was in effect during the 1982-1986 period covered by this litigation.

From the history surrounding its adoption, it is plain that the Gas Market Demand Rule does not and cannot have the effect of overriding take-or-pay provisions in gas purchase agreements between producers and purchasers and does not provide a defense for the breach of those contractual obligations. This is clear from the Travis County district court's holding that the portion of the interpretive order which stated that the rule superseded private contractual provisions was invalid and the Railroad Commission's subsequent omission of the offending language in the replacement interpretive order.

In adopting the current Gas Market Demand Rule, Rules 30 and 34 (sections 3.30 and 3.34), the Railroad Commission again stated that such regulations were not intended to modify existing private contractual relationships. In the preamble to those rules, the Railroad Commission carefully describes the scope of those rules:

> Sections 3.30 and 3.34 are not intended to be a comprehensive statement of rights or obligations under the Common Purchaser Act, nor are they intended to preclude any complaints which may

> arise under that Act. *These amendments shall not affect existing contractual rights and obligations between parties.* 12 TEX. REG. 536 (1987).

The above history of the Gas Market Demand Rule is discussed in *Valero Transmission Co. v. Mitchell Energy Co.*, 743 S.W.2d 658 (Tex. App.—Houston [1st Dist.] 1987), where the Court held that the Railroad Commission's prorationing and ratable take system does not interfere with the terms of gas purchase contracts. The Court there held:

> Although the Texas Railroad Commission is given general statutory authority to regulate the production of gas, the Commission does not have authority to hear contract disputes or to abrogate the parties' respective rights under the gas purchase contract. *See Railroad Comm'n v. City of Austin*, 524 S.W. 2d 262 (Tex. 1975); *see also Humble Oil & Refining Co. v. Railroad Comm'n*, 133 Tex. 330, 128 S.W.2d 9 (1939); *Railroad Comm'n v. United Gas Pipe Line Co.*, 358 S.W.2d 907 (Tex. Civ. App.-- Austin 1962, writ ref'd n.r.e.); A. Anderson, The Texas Approach to Gas Proration and Ratable Take, 57 U. Colo. L. Rev. 199, 220-21 (1986). Indeed, the Texas Railroad Commission, in adopting 16 Tex. Admin. Code secs. 3.30, 3.34 (1987), has itself expressly acknowledged that these rules "shall not affect existing contractual rights and obligations between parties." 12 TEX. REG. 536 (February 17, 1987).

Id. at 660.

The Court stated further:

> [A]s discussed above, the Railroad Commission has no authority to abrogate contract rights. Nor do the Railroad Commission rules purport to affect contract

Court took comfort in the fact that since the injunction required the taking of an "allowable" now set at zero, no violation of the law was taking place. *Valero Transmission Co.*, 743 S.W.2d at 665-66.

Lively also falsely claims that *Mitchell* undermines the effect of the *force majeure* clause in the Contract The *force majeure* clause in the *Mitchell* case, however, did not include "failure of markets" as a specified event of force majeure, as did the Lively Contract's *force majeure* clause. In *Kodiak 1981 Drilling Partnership v. Delhi Gas Pipeline Corp.*, 736 S.W.2d 715 (Tex. App. — San Antonio 1987, writ ref'd n.r.e.), this Court recently held that a *force majeure* provision specifying failure of markets as an event of *force majeure* relieved the pipeline of its take-or-pay obligation. *Kodiak* is directly on point, and eviscerates Lively's argument.

Lively contends that the take-or-pay provision is not "violative of any law or the Gas Market Demand Rule, because it does not require production but payment in lieu of production." (Motion, p. 8). Again, Lively misses the point. The Contract itself limits Valero's payment obligation to the amount that Lively can legally produce and Valero can legally take.

Lively asserts that the Court's opinion does not give effect to the take-or-pay provision. To the contrary, it is Lively that wholly disregards the Contract's plain terms and essentially asks this Court to impose payment obligations on Valero beyond those specified in the Contract. Therefore, the principles of contract construction set forth in the Motion (pp. 8-9) support Valero's position.

Each Contract stands on its own terms. This Court properly construed the Contract, and heeded its provisions that limited Valero's payment obligation to the amount Lively could legally produce and Valero could legally take. Lively has never refuted that Valero took from Lively all the gas Lively could legally produce and Valero could legally take. Valero therefore complied with the Contract.

9. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THE TRIAL COURT PROPERLY SUBMITTED TO THE JURY SPECIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF THE TERM "DELIVERABILITY" FROM THE "DEFINITIONS" SECTION (ARTICLE I[j]) OF THE CONTRACT.
10. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT LIVELY WAIVED ITS OBJECTION TO SPECIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF "DELIVERABILITY" FROM ARTICLE I(j) OF THE CONTRACT.
11. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THE INSTRUCTIONS TO SPECIAL ISSUE NO. 2 WERE RELEVANT, WERE NOT A COMMENT ON THE WEIGHT OF THE EVIDENCE, AND DID NOT CAUSE THE RENDITION OF AN IMPROPER JUDGMENT.
12. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT IN CONSIDERING THE ENTIRE SET OF INSTRUCTIONS TO SPECIAL ISSUE NO. 2 AND THE ENTIRE CHARGE, THE INSTRUCTION CONTAINED IN THE THIRD PARAGRAPH OF THE INSTRUCTION TO SPECIAL ISSUE

NO. 2 WAS NOT A COMMENT ON THE WEIGHT OF THE EVIDENCE AND PROBABLY DID NOT CAUSE THE RENDITION OF AN IMPROPER JUDGMENT.

13. REPLY POINT OF ERROR: THE COURT CORRECTLY OVERRULED APPELLANTS' POINTS OF ERROR THREE, FOUR, AND FIVE.

Lively submitted the very instruction of "deliverability" of which it now complains. This alone justifies the Court's Opinion, and compels denial of its Motion.

Lively preposterously asserts that "when viewed in their entirety the extensive objections were sufficient and . . . there was no waiver that would preclude the consideration by this Court of the points of error contained in the Brief for Appellants and this Motion." (Motion, p. 13). Whether considered in their entirety, or separately, Lively's objections include *no objection* to the definition of "deliverability" in the charge. In fact, *Lively* submitted the definition, so it would be contradictory to impute an "objection" to a definition Lively submitted.

Moreover, for reasons discussed extensively in Appellee's Brief and the Opinion, the issue submission was entirely proper, and thus could not have nudged the jury in the wrong direction. *(See* Appellee's Brief, pp. 25-34).

15.* REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THE TRIAL COURT FAIRLY SUBMITTED SPECIAL ISSUE NO. 2 AND PROPERLY CONDITIONALLY SUBMITTED SPECIAL ISSUE NO. 3.

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* Lively presented no 14th point of error in its Motion.

16. REPLY POINT OF ERROR: THE COURT PROPERLY OVERRULED APPELLANTS' POINT OF ERROR SIX.

The response to these points of error is thoroughly addressed in Appellee's Brief. In sum, the ultimate and controlling issue was liability, the inquiry of Special Issue No. 2. Special Issue No. 2 is in fact worded almost exactly the way Lively described the central issue in its own Brief. *(See* Appellee's Brief, pp. 32-33). Conditioning submission of the damages issue upon an answer to the controlling liability issue was proper.

17. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT LIVELY CONCEDED THAT THE EVIDENCE OF THE GAS MARKET DEMAND RULE SUPPORTS THE JURY'S FINDING IN SPECIAL ISSUE NO. 2.

18. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THERE WAS EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY.

19. REPLY POINT OF ERROR: THE COURT CORRECTLY HELD THAT THERE IS LEGALLY SUFFICIENT EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY.

20. REPLY POINT OF ERROR: THE COURT CORRECTLY REFUSED TO HOLD THAT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY WAS AGAINST THE GREAT WEIGHT IN PREPONDERANCE OF THE EVIDENCE.

21. REPLY POINT OF ERROR: THE COURT CORRECTLY OVERRULED APPELLANTS' POINTS OF ERROR SEVEN, EIGHT, AND NINE.

22. REPLY POINT OF ERROR: THE COURT CORRECTLY AFFIRMED THE JUDGMENT OF THE TRIAL COURT.

As established in Appellee's Brief, the uncontroverted evidence in the Record demonstrates that Valero purchased from Lively all the gas Lively could legally produce during the contract years at issue, and thus purchased the "DCQ" as defined in the Contract. Moreover, Lively's own "evidence" glaringly failed to prove its case, even under Lively's erroneous theory that mechanical testing alone should determine "deliverability" instead of the express contract definition. (See Appellee's Brief, pp. 34-49).

23. REPLY POINT OF ERROR: THE COURT'S ACTION IN APPLYING THE TEXAS GAS MARKET DEMAND RULE TO RELIEVE VALERO OF ANY PAYMENT OBLIGATION IN EXCESS OF THAT EXPRESSLY DEFINED BY THE CONTRACT IS NOT INVALID, AS THE NATURAL GAS POLICY ACT DOES NOT PREEMPT THE TEXAS GAS MARKET DEMAND RULE AS APPLIED BY THIS COURT.

24. REPLY POINT OF ERROR: THE GAS MARKET DEMAND RULE AS APPLIED BY THE COURT DOES NOT VIOLATE THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION.

In its Motion, Lively makes two arguments it never before has alleged: that the Gas Market Demand Rule is preempted by the Natural Gas Policy Act, and that it violates the Commerce Clause. (Motion, pp. 20-28).

First, in its Appellant's Brief and Reply Brief Lively never *controverted* the validity of the Gas Market Demand Rule *per se,* or the Railroad Commission's jurisdiction over Lively and Valero. It cannot do so for the first time on rehearing. *See Gillen v. Diadrill, Inc.*, 624 S.W.2d 259, 264 (Tex. App. — Corpus Christi 1981, writ dism'd).

Moreover, its arguments are meritless. Lively cites *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi,* 106 S. Ct. 709 (1986). In *Transco,* however, the court discussed the application of a Mississippi state ratable take order to an *interstate* pipeline, not an intrastate pipeline like Valero. The Court noted in part that Transco's compliance with Mississippi's law "disturbs the uniformity of the *federal* scheme, since *interstate* pipelines would be forced to comply with *varied* state regulations of their purchasing practices." 106 S. Ct. at 712. Thus, *Transco* is wholly inapposite, which perhaps is why Lively never cited or based a point of error upon it in its appellate briefing.

Moreover, the order in *McGoldrick Oil Co. v. United Gas Pipe Line Co.*, C.A. No. H-84-4971 (September 17, 1987) is also inapposite. First, defendant United Gas is again an interstate pipeline.

Incredibly, Lively asserts that "no valid reason exists for distinguishing between interstate and intrastate pipelines. . . ." Lively therefore would welcome the interference of the Federal Energy Regulatory Commission in strictly intrastate dealings, when even the federal courts themselves have not gone this far. The logical extension of Lively's argument is that the Texas Railroad Commission, and the Texas statutes on conservation, are all entirely preempted by the federal regulatory scheme. It is not surprising that none of the cases Lively cites support this proposition.

Moreover, the *McGoldrick* court noted that "the Texas rule is relied on by United solely to free itself of a contractual obligation. . . ." Valero, however, is not relying on the Gas Market Demand Rule to unilaterally *free* Valero of a contractual obligation. Rather, in this case the Contract does not *impose* on Valero any obligation to pay for gas it cannot legally take.

Finally, no case holds, even by analogy, that the Gas Market Demand Rule violates the Commerce Clause.

The Motion presents no valid reasons for rehearing and should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing Valero Transmission Company's Response in Opposition to Appellants' Motion for Rehearing has been served on opposing counsel by certified mail, return receipt requested, on the 18th day of April, 1988.

By /s/ CARRIN F. PATMAN
Carrin F. Patman

NO. C-7676

IN THE
SUPREME COURT OF TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Petitioners

vs.

VALERO TRANSMISSION COMPANY,
Respondent

FROM NO. 04-87-00380-CV
IN THE COURT OF APPEALS FOR THE
FOURTH SUPREME JUDICIAL DISTRICT OF
TEXAS AT SAN ANTONIO,
BEXAR COUNTY, TEXAS

RESPONDENT'S REPLY TO APPLICATION FOR WRIT OF ERROR

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COMPLETE LIST OF THE PARTIES

A complete list of the names of all parties follows:

Petitioners:

Lively Exploration Company
Lea Roy Aldwell, Individually
Lea Roy Aldwell
Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased
Jon A. Sonnen
J. Howard Marshall
Ed Farrell
Elizabeth Standish
The Desana Corporation
Jessee L. Dally
Chester H. Kenley
Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased
H. B. Lively
B. Jackson Bandy
Robert L. Banks
Theo B. Bean
William R. Gifford
Charlie Gill, Jr.
Henry Gunders and wife, Elaine Gunders
Kenneth L. Hewitt
Kallman Nashner
Frank Pace, Jr.
Martin B. Seretean
Ray B. Vaughters
Theodore L. Wilkinson

Respondent:

Valero Transmission Company

NO. C-7676

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vs.

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RESPONDENT'S REPLY TO APPLICATION FOR WRIT OF ERROR

To The Honorable Supreme Court of Texas:

Valero Transmission Company, successful appellee in Cause No. 04-87-00380-CV, in the Court of Appeals for the Fourth Supreme Judicial District of Texas at San Antonio, and defendant in the District Court, respectfully submits this Reply to the Application for Writ of Error of petitioners Lively Exploration Company, et al.

I. STATEMENT OF THE CASE

Petitioners Lively Exploration Company, et al. ("Lively") sued respondent Valero Transmission Company ("Valero") for breach of a gas purchase contract ("Contract") requiring Valero to take, or pay for if available, 90% of the quantity of gas Lively had "available for delivery," "not exceeding the maximum . . . rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas. . . ." (Contract, arts. V, I[j]). The jury found against Lively on its take-or-pay claim, and the trial court entered judgment in favor of Valero. The court of appeals affirmed the trial court's judgment. Lively has filed an Application for Writ of Error ("Application") with this Court.

The court of appeals' opinion correctly states the nature and results of the suit.

II. REPLY TO STATEMENT OF JURISDICTION

The Supreme Court has no jurisdiction to consider the Application because the holdings of the Court of Appeals to which Lively objects were correct holdings of substantive law.

III. REPLY POINTS OF ERROR

Reply Point of Error 1:

THE COURT OF APPEALS CORRECTLY HELD THAT THE TEXAS GAS MARKET DEMAND RULE APPLIES IN DETERMINING THE OBLIGATIONS OF VALERO UNDER THE TAKE-OR-PAY PROVISION OF THE CONTRACT. (Reply to Lively's Point of Error 1)

Reply Point of Error 2:

THE COURT OF APPEALS CORRECTLY HELD THAT THE GAS MARKET DEMAND RULE WAS RELEVANT AND MATERIAL TO PROVE OR DISPROVE THAT THERE WAS A BREACH OF THE TAKE-OR-PAY PROVISION OF THE CONTRACT. (Reply to Lively's Point of Error 2)

Reply Point of Error 3:

THE COURT OF APPEALS CORRECTLY HELD THAT THE INCLUSION OF THE TEXAS GAS MARKET DEMAND RULE IN THE CHARGE TO THE JURY WAS NOT HARMFUL ERROR. (Reply to Lively's Point of Error 3)

Reply Point of Error 4:

THE COURT OF APPEALS CORRECTLY HELD THAT THE OBLIGATIONS OF VALERO UNDER THE TAKE-OR-PAY PROVISION OF THE CONTRACT ARE CONTROLLED BY THE DEFINITIONS OF "DAILY CONTRACT QUANTITY" AND "DELIVERABILITY" SET FORTH IN ARTICLE I OF THE CONTRACT. (Reply to Lively's Point of Error 4)

Reply Point of Error 5:

THE COURT OF APPEALS CORRECTLY HELD THAT THE TRIAL COURT PROPERLY SUBMITTED TO THE JURY SPECIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF "DELIVERABILITY" FROM ARTICLE I(j) OF THE CONTRACT. (Reply to Lively's Point of Error 5)

Reply Point of Error 6:

THE COURT OF APPEALS CORRECTLY HELD THAT LIVELY WAIVED ITS OBJECTION TO SPE-

CIAL ISSUE NO. 2 AND INSTRUCTION NO. 2 CONTAINING THE DEFINITION OF "DELIVERABILITY" FROM ARTICLE I(j) OF THE CONTRACT. (Reply to Lively's Point of Error 6)

Reply Point of Error 7:

THE COURT OF APPEALS CORRECTLY HELD THAT THE INSTRUCTIONS TO SPECIAL ISSUE NO. 2 WERE RELEVANT, WERE NOT A COMMENT ON THE WEIGHT OF THE EVIDENCE, AND DID NOT CAUSE A RENDITION OF AN IMPROPER JUDGMENT. (Reply to Lively's Point of Error 7)

Reply Point of Error 8:

THE COURT OF APPEALS CORRECTLY HELD THAT THE TRIAL COURT FAIRLY SUBMITTED SPECIAL ISSUE NO. 2 AND CONDITIONALLY SUBMITTED SPECIAL ISSUE NO. 3 (Reply to Lively's Point of Error 8)

Reply Point of Error 9:

THE COURT OF APPEALS CORRECTLY HELD THAT LIVELY CONCEDED THAT THE EVIDENCE OF THE GAS MARKET DEMAND RULE SUPPORTED THE JURY FINDING AND SPECIAL ISSUE NO. 2. (Reply to Lively's Point of Error 9)

Reply Point of Error 10:

THE COURT OF APPEALS CORRECTLY HELD THAT THERE WAS EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY. (Reply to Lively's Point of Error 10)

Reply Point of Error 11:

THE COURT OF APPEALS CORRECTLY HELD THAT LEGALLY CORRECT EVIDENCE SUPPORTS THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY. (Reply to Lively's Point of Error 11)

Reply Point of Error 12:

THE COURT OF APPEALS' ACTION IN APPLYING THE TEXAS GAS MARKET DEMAND RULE TO RELIEVE VALERO OF ANY PAYMENT OBLIGATION IN EXCESS OF THAT EXPRESSLY DEFINED BY THE CONTRACT IS NOT INVALID, AS THE NATURAL GAS POLICY ACT DOES NOT PREEMPT THE TEXAS GAS MARKET DEMAND RULE AS APPLIED BY THIS COURT. (Reply to Lively's Point of Error 12)

Reply Point of Error 13:

THE GAS MARKET DEMAND RULE AS APPLIED BY THE COURT OF APPEALS DOES NOT VIOLATE THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION. (Reply to Lively's Point of Error 13)

IV. STATEMENT OF FACTS PERTINENT TO ALL REPLY POINTS OF ERROR.

A. *The Parties.*

Valero is a public utility intrastate gas pipeline company that purchases, transports, and sells natural gas throughout the State of Texas. Valero operates over 7,000 miles of pipeline connected to over 13,000 wells.

(S.F. 542, 677.) Valero's customers include gas distribution companies that service cities such as San Antonio, Austin, and Dallas, industrial consumers, and other pipeline companies. (S.F. 529-30.)

Lively is comprised of producers, operators, royalty interest owners, and sellers of oil and gas in Texas. (S.F. 105-07). Valero and Lively agree that they are at all times subject to the regulatory authority of the Railroad Commission of Texas ("Commission"). Tex. Rev. Civ. Stat. arts. 6050-53 (Vernon 1962 and Vernon Supp. 1987); Tex. Nat. Res. Code Ann. Sec. 81.051, 111.081 (Vernon 1978). (S.F. 419-23; 675, 1552, 1556.)

B. *The Contract.*

On February 12, 1973, Lively and Valero's predecessor-in-interest entered into the Contract (P. Ex. 1) for the sale of natural gas produced from Lively's properties in Sutton County, Texas. At the time Lively and Valero entered into the Contract, demand for natural gas far outstripped supply, and Lively and Valero both concede that neither foresaw the eventual dramatic oversupply that has changed the entire nature of the natural gas industry. (S.F. 147-48, 593-94.)

Lively and Valero included various provisions in the Contract relevant to this lawsuit. Among these provisions is a "take-or-pay" provision:

> ***Subject to the other provisions hereof,*** Buyer agrees to purchase and pay for (or, ***if Buyer's performance hereunder is not excused by other provisions of this agreement,*** pay for, *if available,* whether taken or not) during the days of each Contract year . . . a ***Daily Contract Quantity*** of gas from Seller's Lands

> and Leases in the Contract Area equal to ninety percent (90%) of Seller's daily *Deliverability* of gas hereunder.

(P. Ex. 1, p. 12, Art V, § 5.3) (emphasis supplied).

The take-or-pay provision references two specific terms that are defined in the Contract and operate with the take-or-pay clause to set forth Valero's take-or-pay obligations: "Daily Contract Quantity" ("DCQ") and "Deliverability." The Contract defines "DCQ" as "the quantity of gas per day, averaged over each contract year, which Buyer is required to take from Seller hereunder at the point of delivery specified in this Agreement." (P. Ex. 1, p. 2, art. I[e].)

Since the Contract states that the DCQ is 90% of *Deliverability,* the extent of any take-or-pay obligation must be measured in accordance with the specific Contract definition of "Deliverability":

> [T]hat quantity of gas which Seller *has available for delivery* from the Lands and Leases to Buyer during each day, in conformity with the requirements of this Agreement, at a constant rate of flow, when Seller's wells and facilities are not produced in excess of their maximum efficient rate of flow, but *not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.* Buyer agrees to make nominations, or to cooperate with Seller in the making of nominations, for well allowables (to be fixed or permitted by rules, regulations or orders of the Texas Railroad Commission) sufficient to cover the daily quantities which from time to time Buyer is entitled and elects

> to take hereunder up to the maximum quantity in accordance with good engineering and gas production practice can be produced from Seller's wells in the field.

(P. Ex. 1, p. 3, art. I [j]) (emphasis supplied.)[1]

Thus, the Contract's take-or-pay provision requires Valero to take, or pay for *if available*, 90% of the quantity of gas Lively has *available for delivery, not to exceed* the maximum production allowed by the Commission.

The take-or-pay provision was included to reassure Lively that Valero would not discriminate against Lively by taking gas from a producer with a lower price to the exclusion of Lively, whose gas in the subject area was dedicated to the Contract.

The Contract also includes a "regulatory bodies" clause expressly making the Contract *subject to* Texas laws and the rules and regulations of an "authority having jurisdiction" such as the Commission:

> This Agreement is made *subject to* all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction.

(P. Ex. 1, p. 27, art. XIII, § 13.1.)

Additionally, the parties included a *force majeure* clause, specifying failure of markets as an event of *force majeure:*

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[1] Although in its Application for Writ of Error, Lively argues that the Contract also contains another definition of "Deliverability," throughout trial the definition in art. I(j) was accepted as the proper one by *both sides*. Lively in fact submitted *only the definition* in art. I(j) of "Deliverability" as an instruction in its proposed charge.

> If either party hereto is rendered unable, wholly or in part, by force majeure, or other causes herein specified, to carry out its obligations under this Agreement, other than any matured obligation to pay money, it is agreed that upon notice . . . then the obligations of the party giving such notice, so far as they are affected by such force majeure or other causes herein specified, shall be suspended during the continuance of any inability so caused. . . .
>
> * * *
>
> The term "force majeure" as employed herein includes without limitation by the following enumeration acts of God . . . *temporary failure of wells or sources of supply of gas, or market;* and any other causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension and which by the exercise of due diligence such party is unable, wholly or in part, to prevent or overcome. . . .

(P. Ex. 1, pp. 26-26A, art. XII, §§ 12.1,12.2.)

C. *Relevant Laws and Regulations.*

1. *The Regulated Nature of the Texas Oil and Gas Industry.*

The repeated deference in Contract provisions to Texas laws and Commission rules and regulations reflects the parties' recognition that the Commission regulates basically all facets of the drilling, production, transportation, and use of natural gas in Texas. (S.F. 419-23, 1474.)

The Commission's authority is accorded by the Texas Natural Resources Code ("Code"). The Code declares "waste" to be unlawful, and defines "waste" as *"the production of natural gas in excess of* transportation or market facilities, or *reasonable market demand* for the type of gas produced." Tex. Nat. Res. Code Ann. § 86.001-.012 (Vernon 1978) (emphasis supplied) (S.F. 1491). The Code charges the Commission with adopting "all necessary rules" to ensure production of natural gas in accordance with market demand and to prevent its *waste*. Code §§ 85.051, 85.052, 86.001, *et seq*., 111.081, *et seq*. (Vernon 1978 and Vernon Supp. 1987) (emphasis supplied.)

The Commission also implements the Code's goal of "compelling *ratable* production," Code § 86.001, and carries out the Texas Common Purchaser Act's stipulation that a pipeline such as Valero must purchase gas without discrimination in favor of one producer or person against another producer or person in the same field and without unjust or unreasonable discrimination between fields in Texas. Code § 111.083 and § 111.086.

2. *The Gas Market Demand Rule Adopted in 1978.*

To discharge its Code-prescribed duties of conserving Texas' precious natural gas in an equitable manner, in 1978 the Commission adopted a system to "prorate" natural gas production — i.e., to determine the overall quantity of natural gas that should be produced in Texas in a given month and to assure that each producer is allowed to produce his fair share of that amount. (S.F. 1551.) The heart of this system, and one of the primary regulations with which Valero and Lively are required to comply, is known as the Gas Market Demand Rule. 16 Tex. Admin. Code § 3.91 ("§ 3.91") (prior to 9/1/86) and 16 Tex. Admin. Code § 3.30 ("§ 3.30") and § 3.34 ("§ 3.34") (from and after 9/1/86, as amended effective 3/2/87) ("Gas Market Demand Rule" or "Rule"). (D. Ex. 7; S.F. 1491-94.)[2]

Both Valero and Lively *agree* on what the Gas Market Demand Rule says and requires. At trial, Valero presented uncontroverted testimony by John Poerner ("Poerner"), a Railroad Commissioner when the Gas Market Demand Rule was adopted and subsequently chairman of the Commission, who thoroughly explained the Rule and its operation. (S.F. 1472-1556.)

As Poerner elucidated, and as Lively concedes, the Rule's gravamen is two-fold. First, it requires an intrastate pipeline company such as Valero: (i) *to limit its purchases* of gas from producers to proportionate shares of the pipeline's downstream market demand; (ii) *to allocate its purchases* "ratably" (without discrimination) among its various producers; and (iii) to purchase various categories of gas, established by the Commission, in a specified order of priority. 16 Tex. Admin. Code § 3.91 (prior to 9/1/86); (D. Ex. 7, 21; S.F. 324-25, 689, 693, 910, 989, 1007, 1050, 1494).

Second, it proscribes a *producer* such as Lively from producing gas in excess of its ratable share of its purchaser's downstream market demand. (S.F. 935, 989, 1050, 1552, 1556.) The achievement of ratability *requires* participation by the producers, since producers, not pipelines, have physical control of the wells and the quantity of gas actually produced. (S.F. 715, 1344.)

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[2] The Gas Market Demand Rule as issued on January 16, 1978 was introduced into evidence as D. Ex. 7. Lively objected to evidence of amendments after the Contract years at issue, and the trial court excluded such evidence. Thus, all citations to sections of the Gas Market Demand Rule are to the sections as in effect during the Contract years at issue, and as reflected in D. Ex. 7.

To ensure that production and takes are in accordance with market demand, the Gas Market Demand Rule explicitly sets forth steps that producers and pipelines must follow each month. To summarize, early each month a pipeline's downstream customers give the pipelines "nominations" of their "firm forecast of . . . [their] actual demand." (D. Ex. 7, § .001(d) (2) (A); S.F. 683-84.) The pipeline then files its own nomination with the Commission reflecting the amount of gas it expects to take from each field. (S.F. 1318-19.) The pipeline must nominate an amount *equal to* the total quantity for which it is the ultimate consumer and the total quantity nominated by its downstream purchasers. (D. Ex. 7, § .001(d); S.F. 682-84.) In making its nominations, a pipeline must "ratably apportion" them from the fields from which it purchases and from the gas wells connected to its system. (D. Ex. 7, § .001(e).) A pipeline must also make its nominations according to the Commission's "priority system" of different categories of gas. *Id.* The priority system requires a pipeline to nominate, take, and exhaust all of a higher category of gas available from its producers before taking any gas in a lower category. *(Id.,* D. Ex. 20; S.F. 693, 1324-25.)[3]

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[3] Specifically, under the 1978 Gas Market Demand Rule "casinghead gas" was given the highest priority, followed by gas classified as "Rule 49(b)" gas as second priority, and "special allowable" gas as third priority. (S.F. 591, 622, 689, 1494.) Valero must purchase all ***priority gas*** ("casinghead," then "Rule 49(b)," and then "special allowable" gas) dedicated to its system before it can purchase ***any non-priority*** gas (such as the prorated "gas well gas" produced by Lively). (S.F. 693.) The Commission established the priority categories based on sound public policy considerations. For example, in according casinghead gas highest priority the Commission was mindful of the Arab oil embargo, since curtailment of casinghead gas interrupts oil production. (S.F. 1494.)

The pipeline then tells its producers the amount it intends to nominate, so that they can forecast production. (S.F. 685-86, 1321.) The Commission adds up nominations of all pipelines taking gas from a given field, divides that number among the wells in a field and allocates an amount of production to each particular well. (S.F. 1499-1500.) This amount is the well's "full prorated allowable." (S.F. 1336, 1500.)

Because actual market demand may deviate from the amount projected by a pipeline in its nomination, each month a pipeline gives each of its producers a "rate of flow request" letting it know the pipeline's actual market demand, and how much gas the producer should tender to supply its ratable share of that market demand. (S.F. 686-87.) If the pipeline's demand is less than projected in its nomination, production from each well *must* be reduced ratably (proportionately), even though the well's "allowable" may be set at a higher amount. (S.F. 687.) Based on the procedures outlined in the Gas Market Demand Rule a pipeline then purchases gas without discrimination and in accordance with the priority categories. (S.F. 934.)

In summary, the overriding goal of Texas' complex and carefully drawn regulatory scheme governing the oil and gas industry is to ensure that production of natural gas does not exceed market demand and result in "waste" as that term is defined by statute, and that production of the market demand is fairly apportioned among producers. (S.F. 1491-93, 1499, 1551.)

D. *The Interface Between the Gas Market Demand Rule and the Contract.*

Pursuant to the *parties' own agreement* as reflected throughout the Contract, the take-or-pay provision and Gas Market Demand Rule work in tandem to define Valero's take-or-pay obligations. Both Valero's obligation to take and its alternative obligation to pay are limited *by the Contract's own terms* to the quantity Lively has "available for delivery," "not exceeding the maximum rate of flow permitted by [Commission rules and regulations]." The Gas Market Demand Rule therefore governs the amount of gas Lively can have "available for delivery" at a given time, and establishes that the "maximum . . . rate of flow" under the Contract can never exceed Valero's downstream market demand.[4]

It is *uncontroverted* that Valero's downstream market demand has drastically declined. (S.F. 568, 571, 1040, 1483-84, 1532; D. Ex. 11A, 38, 64.) It was similarly undisputed at trial (and Petitioners have not argued otherwise in their Application or before the court of appeals) that *during the Contract years in issue Valero nominated and requested all of Lively's gas for which Valero had a downstream market demand.* (S.F. 1349-51, 1376.)[5]

Any quantity exceeding the amount Valero actually took from Lively, therefore, could not be produced pursuant to Commission rules. Thus, the Contract by its own terms did not require Valero either to take or to pay for that amount of gas.

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4. It is worth noting that the Gas Market Demand Rule also established procedures preventing the discrimination the take-or-pay clause was originally included to discourage.

5. Although in its Application Lively vaguely accuses Valero of "manipulation" of its nominations and requests, at trial Lively in fact offered ***no evidence*** whatsoever of any improper "manipulation". In truth, the evidence at trial was uncontroverted that Valero nominated and requested all of Lively's gas for which it had a downstream market demand, and complied fully with Texas laws and Commission rules.

E. *Lively's Lawsuit.*

Despite the fact that Valero had clearly complied with the Contract's take-or-pay provisions, Lively sued Valero for purportedly breaching the take-or-pay clause for the Contract years 1982-1985. Valero therefore found itself in the ironic position of *defending* a breach of contract lawsuit despite its compliance with the plain terms of the Contract.

F. *The Trial.*

At trial, Lively called only three witnesses: Harry Lively, who testified about the Contract although he had not negotiated it (S.F. 149-50); Jimmy Condra, who testified as to the results of alleged "deliverability tests" on the wells even though he had not run the tests himself in the last five years (S.F. 660-61) and even though the pumper he claimed had run the tests testified that he had never run such tests (S.F. 952-53); and Max Powell, who testified as to alleged take-or-pay damages. (S.F. 367-403.)

Valero called a number of witnesses, including: John Poerner, who testified concerning the meaning and import of the Gas Market Demand Rule (S.F. 1447-1552); Frank J. Becraft, President of Valero, and Jeffrey H. Parish, Director of Proration and Producer Affairs of Valero, who testified as to the decline in Valero's downstream market and Valero's strict adherence to the Gas Market Demand Rule (S.F. 531-34, 565-73, 710, 713, 675-936, 1307-76); Travis B. Crow, Valero's Director of Reserve Evaluation, who testified about the unreliability of Lively's "deliverability" tests (S.F. 1191-1271); Dr. Alan Anderson, who testified about the decline in Valero's downstream market (S.F. 982-1051); and several others. Most of Valero's evidence was uncontroverted.

The take-or-pay claims were submitted to the jury. In response to Special Issue No. 2, the jury answered "no" to the question, "Do you find that Valero failed to take or pay for an amount of gas equal to the Daily Contract Quantity ("DCQ")?" (Tr. 145.) Thus, the trial court properly entered a take-nothing judgment against Lively on its take-or-pay claim against Valero. (Tr. 158).

G. *The Appeal.*

Lively appealed the judgment as to its take-or-pay claim. The court of appeals completely affirmed the trial court's judgment. Lively has appealed to this Court.

In its Application, Lively recognizes that it cannot undermine the jury's verdict or the trial court's judgment based on the Record or the applicable law. Therefore, in its Application Lively distorts the plain meaning of some Contract provisions and omits reference to others, mischaracterizes Valero's position, and ignores the overwhelming evidence supporting the jury's findings, most of which Lively did not even attempt to controvert at trial. Lively even complains on appeal of an instruction to the jury that *Lively* submitted.

That Lively cannot rely on the Record as it exists and the Contract as it is written confirms that an accurate characterization of the Contracts, the law, and the evidence compels denial of the Application.

V. THE RELEVANCE OF THE GAS MARKET DEMAND RULE

Reply Points of Error 1-4 In Summary:

THE COURT OF APPEALS CORRECTLY HELD THAT THE CONTRACT LIMITS VALERO'S PAYMENT OBLIGATION TO AN AMOUNT THAT CAN BE LEGALLY DELIVERED.

A. *The Overall Fallacy in Lively's Argument.*

Lively's argument under its First through Fourth Points of Error embodies a complete mischaracterization of Valero's position. Lively erroneously asserts that Valero relies on the Gas Market Demand Rule as unilaterally abrogating otherwise existing contractual obligations:

> Valero seeks to avoid its obligations under [the take-or-pay] provision by asserting that the Railroad Commission Gas Market Demand Rule ***abrogates*** the take-or-pay provision by limiting Valero's obligation to take gas to its market demand and consequently relieves Valero of its obligation to pay for the Daily Contract Quantity of gas not taken. It is Petitioners' position that as a matter of law the Gas Market Demand Rule does not affect the rights and obligations of the parties to this contract by relieving Valero of its obligation to pay for the minimum quantity of gas provided by the Contract.

(Application. p. 13) (emphasis supplied.)

This is not Valero's position at all, and by making such an argument, Lively is merely assailing a "straw man." Whether the Gas Market Demand Rule unilaterally *abrogates* the take-or-pay provision is ***not the issue*** in this appeal. Rather, the issue is the interpretation of *this* Contract, in which the *quantity* of gas Valero is required to take *or pay for* is *defined* as an amount "available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission] rules." (P. Ex. 1, p. 3, art. I[j].)

As explained in § IIIB, *supra*, the take-or-pay provision requires Valero to take or pay for 90% of Seller's daily Deliverability. Deliverability is defined in the Contract as the "quantity of gas which Seller has *available for delivery . . . but not exceeding the maximum (including overproduction) rate of flow permitted by the laws, rules and regulations of the Railroad Commission of Texas or other governmental regulatory agency having jurisdiction.*" Thus, the *Contract* itself states that Commission rules and regulations can limit Valero's obligation to take *and* its alternative obligation to pay. The Contract does not require Valero's *payment* for a minimum quantity of gas as measured in Mcfs or Btus; it requires payment for a certain *percentage* of "Deliverability," a defined term that embodies the concept that it is limited by Commission rules and regulations.

Lively's entire argument under its First through Fourth Points of Error, the bulk of its Application, is therefore based on a faulty premise, and ignores the plain words of this Contract. In essence, through its lawsuit Lively sought to *rewrite* and engraft into the Contract a provision the parties did not include.

Lively seeks to capture this Court's attention by claiming, in italics:

> This is the first time a Texas court has made such a holding [that the Gas Market Demand Rule unilat-

Id. at 423. The Court thus recognized the validity of take-or-pay provisions of gas contracts where pipelines are committed to purchase gas in excess of market demand.

Following the Supreme Court's holding in *Transco,* the United States District Court, Southern District of Texas, Houston Division, in *McGoldrick Oil Company, et al v. United Gas Pipe Line Company,* Civil Action No. H-84-4971, by order of September 17, 1987, held:[14]

> The Texas Gas Market Demand Rule, governing ratable production, is preempted under *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi,* ___U.S.___, 106 S. Ct. 709 (1986). Although states may regulate the production of natural resources in order to achieve a statewide public benefit, such as conservation, *the Texas rule is relied on by United solely to free itself of a contractual obligation. If the rule were enforced to free pipelines of their obligations under take-or-pay contracts, its effect would be contrary to the public interest sought to be served by the federal regulation: gas prices would remain high in spite of an oversupply.*

In a Memorandum on Denial of Modification of the above order,[15] that Court stated as follows:

> United Gas Pipe Line's motion to modify the order of September 17, 1987, will be denied. The September order modified an earlier June memorandum, making is consistent with Transcontinental Gas Pipe Line Corporation v. State Oil and Gas Board of Mississippi, ___U.S.___, 106 S. Ct. 709 (1986).

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[14] Appendix at A55.

[15] Appendix at A58.

> Had United wanted to limit its takes of gas under its contract with McGoldrick during periods when gas was in surplus supply, it could have negotiated a market out clause. The contract was drafted by sophisticated attorneys for clients with substantial experience in gas production and marketing. *Allegations that United in good faith believed that the contract's incorporation of the Texas Gas Market Demand Rule was to work as a substitute for a market out clause which could be invoked when the price and demand for gas dropped are disingenuous.* United signed a contract for mandatory minimum purchases of gas during a time of inflated gas prices, gambling that the economy would remain favorable to suppliers. Even if United lacked the capacity immediately to take and resell McGoldrick's gas, it was not commercially impracticable for United to pay for the gas, as it was contractually obligated to do.
>
> The court's September order did not invalidate the Texas ratable production scheme. As Transco has instructed, the statute remains enforceable to achieve certain state goals such as preservation of resources, protection of correlative rights, and waste prevention. Congress' intent to move toward a less-regulated national gas market cannot be interpreted as an invitation to the states to impose additional regulations. Transco at 717. The Texas Gas Market Demand Rule, as applied to purchasers such as United, is preempted, 106 S. Ct. at 718.

In *ANR Pipeline Co. v. Corporation Commission of Oklahoma,* 643 F.Supp. 419 (W.D. Okla. 1986), the Court held the Oklahoma statute and the Oklahoma Corporation Commission Rule 1-305 to be "*unconstitutional as applied to the plaintiffs*" in that case. *Id.* at 424. That statute and rule, like the Texas Gas Market Demand

Rule, provides for ratable purchases of gas by pipelines from a common source of supply on a systemwide basis and establishes a priority schedule for the purchase of gas when production exceeds that purchaser's market demand.

In *Schneidelwind v. ANR Pipeline Co.,* 56 U.S.L.W. 4249 (March 22, 1988), the United States Supreme Court held that a Michigan statute "regulates in a field the NGA has occupied to the exclusion of state law, and that it is therefore preempted." *Id.* at 4251. The statute required a public utility exercising or claiming the right to transport natural gas for public use to obtain approval from the Michigan Public Service Commission before issuing long term securities. Referring to the "comprehensive scheme of federal regulation" in the Natural Gas Act, the Court stated that "while the NGA does not expressly grant FERC preissuance authority over the securities of natural gas companies, FERC achieves the regulatory ends of such review with regard to rates and facilities through the exercise of its express regulatory responsibilities." *Id.* at 4254. In view of its conclusion that the Michigan statute "is pre-empted by the NGA," the Court stated that "we need not decide whether, absent federal occupation of the field, Act 144 violates the Commerce Clause. *See Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Bd. of Mississippi,* 474 U.S. 409, 425 (1986)." *Id.* at 4254.

As recognized in *Transco,* the NGPA resulted in "unification of the interstate and intrastate markets," and now there is a "national natural gas market." 474 U.S. at 423-424. That this is the case is further evidenced by the fact that Section 105 of the NGPA covers "sales under existing *intrastate* contracts."

The authority given by the NGPA to FERC to regulate the price of "all first sales of natural gas irrespective of its interstate or intrastate character" was upheld in *State of Oklahoma v. Federal Energy Regulatory Commission,* 661 F.2d 832 (10th Cir. 1981), *cert. denied,* 457 U.S. 1105 (1982). The Court there held that "the enactment of the NGPA is a constitutionally acceptable exercise of Congress' Commerce Clause power." 661 F.2d at 838. The basis of the Court's holding, among other things, was that Congress may regulate wholly intrastate activities which have "a substantial economic effect on interstate commerce or when the intrastate activity is necessary to effectuate the interstate regulation"; "Congress had a rational basis for determining that the unregulated intrastate market imposed a burden on interstate commerce"; and "Congress may preempt state conservation regulations which interfere with or burden interstate commerce." *Id.* at 834-835.

In considering the validity of state ratable take rules such as the Texas Gas Market Demand Rule, there is no longer any valid reason for differentiating between interstate and intrastate pipelines. Both pipelines purchase from the same producers, the same fields, and even the same wells, and the maximum price of the first sales to them is regulated by FERC irrespective of the destination of the gas. Therefore, the Texas Gas Market Demand Rule as applied by the Court of Appeals is not only pre-empted by the NGPA but also runs afoul of and violates the Commerce Clause of the United States Constitution.

Even if, as Valero contends, the definition of "Deliverability" in Article I(j) of the contract can be construed as limiting Valero's takes of gas to its market demand under the Gas Market Demand Rule, that portion of the agreement would be unenforceable here since during the Contract Years in question the Gas Market Demand Rule as so applied by the Court of Appeals is pre-empted by the NGPA and violates the Commerce Clause. "Parties, by contract, cannot impair the validity of a law, nor control or limit the provisions of a statute." *McFarland v. Haby,* 589 S.W.2d 521, 524 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.); *Gorman v. Gause,* 565 S.W.2d 855 (Tex. Comm'n App. 1933, judgmt adopted).

The Gas Market Demand Rule need not be, and was not intended by the Railroad Commission to be, applied in the manner applied by Valero and the Court of Appeals. The proper application of that rule, by holding that it does not relieve a gas purchaser of its alternative obligation under the take-or-pay provision of a gas contract to pay for the minimum quantity of gas it agreed to take, not only is in accord with the Railroad Commission's intention in promulgating the rule but also avoids the rule being pre-empted by the NGPA and being violative of the Commerce Clause of the United States Constitution.

CONCLUSION

The Court of Appeals clearly erred in the respects set forth in the above Points of Error. For the reasons stated, the Supreme Court of Texas should grant the application for writ of error and reverse the judgment of the Court of Appeals and of the Trial Court and take other action as requested in the Prayer for Relief.

PRAYER FOR RELIEF

Petitioners respectfully request that this Court reverse the judgment of the Court of Appeals for the Fourth Supreme Judicial District of Texas and of the Trial Court that Lively take nothing by way of their take-or-pay cause of action, render judgment that Valero is liable to Lively for its failure to pay for the Daily Contract Quantity under the contract for the Contract Years 1982, 1983, 1984, and 1985, remand the case for a new trial as to the amount owed to Lively by Valero, in all other respects affirm the Trial Court's judgment, and grant Petitioners Lively such other and further relief to which they may be justly entitled, including the taxing of the costs to the Respondent.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that Petitioners' Application for Writ of Error was served on the Respondent by mailing a true copy to its attorney by certified mail, return receipt requested, by depositing it, postpaid, in an official depository under the care and custody of the United States Postal Service on the 15th day of June, 1988, enclosed in a wrapper addressed as follows:

J. Clifford Gunter, III
Bracewell & Patterson
2900 South Tower Pennzoil Place
Houston, Texas 77002

/s/ JESSE P. LUTON, JR.
Jesse P. Luton, Jr.

No. C-7676

IN THE
SUPREME COURT OF TEXAS
AUSTIN, TEXAS

LIVELY EXPLORATION COMPANY, ET AL.,
Petitioners,

v.

VALERO TRANSMISSION COMPANY,
Respondent.

MOTION FOR REHEARING

To The Honorable Supreme Court Of Texas:

Lively Exploration Company, Lea Roy Aldwell, Individually, Lea Roy Aldwell, Winnie Lea McPherson and Marjory Reba Johansen, as Testamentary Trustees under the Will of George L. Aldwell, Deceased, Jon A. Sonnen, J. Howard Marshall, Ed Farrell, Elizabeth Standish, The Desana Corporation, Jessee L. Dally, Chester H. Kenley. Carolyn H. Joseph, Independent Executrix of the Estate of Gifford E. Joseph, Deceased, H.B. Lively, B. Jackson Bandy, Robert L. Banks, Theo B. Bean, William R. Gifford, Charlie Gill, Jr., Henry Gunders and wife, Elaine Gunders, Kenneth L. Hewitt, Kallman Nashner, Frank Pace, Jr., Martin B. Seretean, Ray B. Vaughters, and Theodore L. Wilkinson (collectively referred to as "Lively" or "Petitioners"), Petitioners in this cause, make this Motion for Rehearing, and in support thereof show:

I.

On the 7th day of June, 1989, this Court denied Petitioners' Application for Writ of Error in this cause.

II.

This Court erred in not granting the Application for Writ of Error upon Points of Error 1 and 2, which read:

> POINT 1. The Court of Appeals erred in holding that the Texas Gas Market Demand Rule applies in determining the obligations of Valero under the take-or-pay provision of the contract.
>
> POINT 2. The Court of Appeals erred in holding that the Texas Gas Market Demand Rule was relevant and material to prove or disprove that there was a breach of the "take-or-pay" provision of the contract as alleged by Lively.

The Court of Appeals held that the Gas Market Demand Rule applies so as to relieve Valero Transmission Company ("Valero") of its obligations under the "take-or-pay" provision of the natural gas contract. *Lively Exploration Co. v. Valero Transmission Co.*, 751 S.W.2d 649 (Tex. App.—San Antonio 1988, writ denied). The court based its opinion upon the provisions of the contract, including Article XIII, paragraph 13.1, making the agreement "subject to all valid applicable federal and state laws or city ordinances, and to the orders, rules and regulations of any duly constituted federal or state regulatory body or authority having jurisdiction." *Id.* at 656.

The above-quoted government regulation clause is a standard provision in natural gas contracts. However, even if this provision were not in the contract, these laws and regulations would become a part of the contract and govern the transaction. *Wesseley Energy Corp. v. Jennings,* 736 S.W.2d 624 (Tex. 1987); *Langever v. Miller,* 124 Tex. 80, 76 S.W.2d 1025 (1934).

Therefore, the effect of the Court of Appeals' reliance upon the government regulation clause is to hold that the Gas Market Demand Rule relieves *all* pipeline purchasers in Texas of their take-or-pay obligations under *all* of their natural gas contracts in the absence of an express provision to the contrary. This application of the Gas Market Demand Rule is contrary to the clear intention of the Texas Railroad Commission in promulgating that rule and to many rulings of courts in Texas and other states that contractual obligations to pay for gas are not superseded or abrogated by the Gas Market Demand Rule.[1]

This is the first time a Texas court has made such a holding, and its ramifications are far reaching and will have a serious adverse effect on gas producers in this state.

Since the Court of Appeals' opinion, Valero and other natural gas pipeline purchasers have sought to apply that opinion in the manner set forth above so as to relieve them of any obligations under take-or-pay provisions in their gas purchase contracts. This is shown by Exhibit A, pp. 37-38, to the Response of Amici Curiae Cardwell & Hart to Respondent's Reply filed in this Court, in which Valero argued in another case that the Court of Appeals' opinion in this case "conclusively validates" the defense that the Gas Market Demand Rule "obviates" the take-or-pay obligations in gas purchase contracts.

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[1] *See* Application for Writ of Error, pp. 14-24.

Therefore, the opinion of the Court of Appeals and this Court's denial of Petitioners' Application for Writ of Error already have resulted, and will continue to result, in reliance by pipeline companies on the Texas Gas Market Demand Rule as a complete defense to liability under take-or-pay provisions of natural gas contracts.[2]

As shown by the cases discussed in the Application for Writ of Error (pp. 17-24) and in the several amicus curiae briefs filed in support of the application, the trial court and the Court of Appeals erred in failing to hold *as a matter of law* that Valero is not relieved of liability under the take-or-pay provision of this contract by the application of the Gas Market Demand Rule. This Court's denial of the Application for Writ of Error effectively affirms that error and changes or so confuses the law in this state as to leave in doubt the validity of virtually every take-or-pay claim by producers against pipelines under natural gas contracts in this state.

This issue is far too important and involves far too many claims under natural gas contracts totaling hundreds of millions of dollars to leave the situation in the clouded condition it now is in as a result of the Court of Appeals opinion and this Court's denial of the Application for Writ of Error with the notation, Writ Denied.

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[2] In the San Antonio Express-News, June 9, 1989, at 2-B, col. 1, Valero is reported as saying that the "appellate court's decision upheld Valero's defense that compliance with the market demand and ratable take rules of the Texas Railroad Commission can eliminate liability under the take-or-pay provisions contained in many intrastate gas purchase contracts." Bill Greehey, Chairman and Chief Executive Officer of Valero Energy Corp., is quoted in that same article as saying that "the action of the Texas Supreme Court in upholding our defenses in the Lively case will help us to bring about successful resolution of the few take-or-pay claims which remain outstanding." That article also states that Greg Wright, a Valero spokesman, "said about $60 million in take-or-pay claims are still pending against Valero."

III.

The Court erred in not granting the Application for Writ of Error upon Points of Error 12 and 13, which read:

> POINT 12. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals is pre-empted by the Natural Gas Policy Act.
>
> POINT 13. The Court of Appeals' action in applying the Texas Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under the contract is invalid, because the Texas Gas Market Demand Rule as applied by the Court of Appeals violates the Commerce Clause of the United States Constitution.

The Gas Market Demand Rule (D. Ex. 7) requires pipeline companies to limit their purchases of gas from producers to each pipeline company's downstream market demand and to "ratably apportion" its purchases "so that takes from various gas producing properties shall be made without discrimination" among producers in the same field "and without unjust or unreasonable discrimination as between fields." (S.F. IX, 1516-1518). The Gas Market Demand Rule does not distinguish between interstate and intrastate pipeline companies.

The Court of Appeals applied the Gas Market Demand Rule so as to relieve Valero of its take-or-pay obligations and liability under its contract with Lively. The Gas Market Demand Rule as applied by that court is preempted by the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301, *et. seq.*, and violates the Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3. *See Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409 (1986) ("*Transco*"), and *ANR Pipeline Co. v. Corporation Commission of the State of Oklahoma*, 860 F.2d 1571 (10th Cir. 1988), *cert. denied*, 57 U.S.L.W. 3719 (U.S. May 2, 1989) (No. 88-1482). *See also Schneidewind v. ANR Pipeline Co.*, 485 U.S. ___, 99 L.Ed.2d 316 (1988).

In 1978, Congress passed the NGPA, which "has been justly described as 'a comprehensive statute to govern future, natural gas regulation.' Note, Legislative History of the Natural Gas Policy Act, 59 Texas L. Rev. 101, 116 (1980)." *Public Service Commission of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 332 (1983). As stated in the Texas Law Review note from which the United States Supreme Court quoted in the above case: "Congress also recognized the need to eliminate the distinction between the interstate and intrastate markets. Because the regulation-free intrastate market had imposed an opportunity cost on the interstate supply, Congress imposed price controls on intrastate gas in sections 105 and 106(b)." 59 Tex. L. Rev. at 120.

The authority given by the NGPA to FERC to regulate the price of "all first sales of natural gas irrespective of its interstate or intrastate character" was upheld in *State of Oklahoma v. Federal Energy Regulatory Com-*

mission, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982). The Court there held that "the enactment of the NGPA is a constitutionally acceptable exercise of Congress' Commerce Clause power." 661 F.2d at 838. The basis of the Court's holding, among other things, was that Congress may regulate wholly intrastate activities which have "a substantial economic effect on interstate commerce or when the intrastate activity is necessary to effectuate the interstate regulation"; "Congress had a rational basis for determining that the unregulated intrastate market imposed a burden on interstate commerce"; and "Congress may pre-empt state conservation regulations which interfere with or burden interstate commerce." *Id.* at 834-835.

A Mississippi ratable-take rule requiring, like the Texas Gas Market Demand Rule, that pipelines purchase gas without discrimination in favor of one producer against another in the same source of supply was held to be preempted by the NGPA in *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi, supra.* There, the Court stated:

> [T]he NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand. See S Rep. No. 95-436, at 10. The new federal role is to "overse[e] a *national market price regulatory scheme*." Haase, 16 Houston L. Rev, at 1079; see S Rep No. 95-436, at 21 (NGPA implements "a new commodity value pricing approach"). The NGPA therefore does not constitute a federal retreat from a comprehensive gas policy. Indeed, *the NGPA in some respects expanded federal control, since it granted FERC jurisdiction over the intrastate market for the first*

IX. THE OVERWHELMING EVIDENTIARY SUPPORT FOR THE JURY'S FINDINGS AND THE JUDGMENT

Reply Points of Error 9-11 In Summary:

THE COURT OF APPEALS CORRECTLY HELD THAT THERE WAS LEGALLY CORRECT EVIDENCE TO SUPPORT THE JURY'S FINDING ON TAKE-OR-PAY LIABILITY.

Lively's Points of Error Nine through Eleven each involve the evidentiary support for the jury's answer to Special Issue No. 2. The evidence supporting the jury's answer to Special Issue No. 2 is not only legally sufficient, it is overwhelming, and compels affirmance of the trial court's judgment.

A. *The Standard of Review for "No Evidence" or "Legal Insufficiency" Points of Error.*

In reviewing a "no evidence" point, the Court must consider only that evidence and reasonable inferences drawn therefrom in their most favorable light to support the jury's findings, rejecting all contrary or conflicting evidence and inferences. *King v. Bauer,* 688 S.W.2d 845, 846 (Tex. 1985); *Glover v. Texas General Indemnity Co.,* 619 S.W.2d 400, 401 (Tex. 1981); *Ray v. Farmers State Bank of Hart,* 576 S.W.2d 607, 609 (Tex. 1979). A "no evidence" point will not be sustained if there is *any* probative evidence to support the jury's finding. *Ray,* 576 S.W.2d at 609.

B. *The Evidence in the Record.*

The evidence supporting the jury's answer to Special Issue No. 2 is in fact essentially uncontroverted. First, the Record demonstrates that Valero purchased from Lively all the gas Lively could legally produce during the Contract years at issue, and thus purchased the DCQ as defined in the Contract. Second, Lively's own "evidence" glaringly failed to prove its case, even under Lively's erroneous theory that G-10 tests should determine deliverability instead of the express Contract definition.

1. *The Evidence Showed that Valero Took and Paid For the Daily Contract Quantity.*

As thoroughly explained in Section IIIB, *supra*, the Contract requires Valero to take or pay for 90% of the "quantity of gas [Lively] has available for delivery," "not exceeding the maximum . . . rate of flow permitted by [Commission regulations]." At trial Valero presented extensive testimony proving it had taken the DCQ under the Contract. Lively's Application does not refute this evidence, nor did Lively succeed in controverting it at trial.

(a) *The Meaning of the Gas Market Demand Rule.*

Because the Contract does not obligate Valero to take or pay for gas not legally deliverable under the Gas Market Demand Rule, Valero introduced the 1978 Gas Market Demand Rule and offered *undisputed* testimony from former Commission Chairman Poerner and Parish, Valero's Director of Proration and Producer Affairs, concerning the Rule's adoption and meaning. (S.F. 1472-1557; 675-699; D. Ex. 7.) The substance of their testimony is set forth in Section IIIC, *supra*. To briefly reiterate, the Rule: (i) requires Valero to purchase only a proportionate share of a producer's downstream market demand, to allocate its purchases "ratably" among its producers, and to purchase various defined categories of gas in a specified order of priority; and (ii) proscribes Lively from producing more gas than its ratable share, in accordance with the priority categories, of its purchaser's downstream market demand. (D. Ex. 7, 20-21; S.F. 324-25, 689, 693, 710, 910, 935, 989, 1007, 1050, 1494, 1552, 1556.)

(b) *Valero's Compliance with the Gas Market Demand Rule.*

Valero then showed that it had purchased from Lively the maximum quantity under the Rule, and thus took the DCQ as defined in the Contract.

(i) *Valero's Downstream Market Demand Has Dramatically Declined.*

First, Valero established through *unrebutted* evidence that its downstream market demand had declined to a point where it had been forced to drastically curtail purchases from its producers, including Lively.

Alan Anderson ("Anderson"), a specialist in natural gas economics with a Ph.D. in economic history from Johns Hopkins, and Valero's President, Becraft, explained at trial that a natural gas "market" is a function of *price*. (S.F. 533, 554, 1005.) The Commission requires Valero to charge an *inflexible* price for its gas equal to the weighted average of gas ("WACOG") plus $0.15. (S.F. 555, 571; D. Ex. 12.)[7] Over the past few years Valero's

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[7] This requirement is contained in the Final Order in Gas Utilities Docket No. 500 dated September 4, 1979 ("Final Order") (D. Ex. 12; S.F. 556-59.) The Appendix to the Final Order describes in great detail the WACOG calculation. (*See also* S.F. 570-71.)

WACOG plus $0.15 has equalled $4.00 to $4.20 per MMBtu of natural gas. (S.F. 555.) Therefore, Valero's sales market is the market for $4.00 gas. (*Id.*)

That market is currently virtually nonexistent. Due to many factors, including a reduction in industrial consumption and governmental policies adversely impacting demand, a natural gas glut arose approximately in 1981. (S.F. 602, 710, 713, 1040, 1495, 1483-84; D. Ex. 11A, 13A, 38, 94.) Prices for natural gas have fallen accordingly, currently to $1.50 per MMBtu. (S.F. 537.) Thus, Valero's customers can purchase gas, or use alternative fuels, at significantly lower prices than the $4.00 and above that Valero is required to charge them. (S.F. 529-34, 1012; D. Ex. 32.) As customers' contracts with Valero have expired, they have sought cheaper fuel elsewhere. (S.F. 529-34.) Valero's market has been drastically reduced. (S.F. 540, 568; 1040, 1532; D. Ex. 11A, 13A, 38, 64.) Its sales have declined from 620 billion cubic feet of gas in 1981 to 70 billion in 1986. (S.F. 540.) At the same time, its WACOG, including cost of service, has *increased*. (S.F. 571; D. Ex. 11A, 13A.)

The downstream market demand for $4.00 gas, which is Valero's market as established by the Commission, is purely and simply drying up. (S.F. 540, 568, 1040, 1532; D. Ex. 11A, 13A, 38, 94.)

(ii) *Valero's Nominations from Lively and its Other Producers Are in Accordance with its Downstream Market Demand.*

It is undisputed that *Valero has taken all of the gas available to it from Lively consistent with Valero's downstream market demand.* (S.F. 684.)

Parish explained that Valero scrupulously follows the procedures required by the Rule and set forth in § IIIC (2), *supra.* Valero introduced numerous exhibits and offered extensive testimony demonstrating systemwide ratability in accordance with the priority categories. (D. Ex. 16, 17, 18, 19, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 74; S.F. 676-78, 682-85, 684, 695-99, 1307, 1310-11, 1318-21, 1329-32, 1346-53, 1376.) In sum, Valero showed that during the Contract years in issue Valero has been ratable in its nominations and rate requests required by the Gas Market Demand Rule. (S.F. 1376.)

Valero's purchases from Lively have been reduced to virtually zero because Lively produces primarily gas well gas (S.F. 209, 693), non-priority gas, and Valero's market demand has dropped *below* the amount of *priority* gas deliverability. (D. Ex. 63, 64; S.F. 1328-31.) Thus, Valero must satisfy its market demand exclusively through ratable purchases from producers of higher-priority gas. (S.F. 1324-25.) *Valero's nominations have been ratable among the non-priority gas producers.* (S.F. 1332; D. Ex. 64.)

In sum, Valero's uncontroverted evidence showed that it has taken all the gas from Lively "available for delivery," "not exceeding the maximum . . . [production] . . . permitted by [Commission] regulations." Therefore, Valero took and paid for the DCQ under the Contract, and the jury so found.

(c) *Lively's Failure to Address Valero's Evidence That It Took the DCQ.*

In its Application, Lively *does not even attempt to controvert* Valero's evidence that the Gas Market Demand

Rule limits production to the pipeline's market demand, and that Valero has taken all the gas from Lively for which it has a downstream market demand. Lively's brief argument under Ninth through Eleventh Points of Error focuses *exclusively* on the same irrelevant refrain sung throughout its Brief: that the Rule does not "abrogate" Valero's alleged obligation to pay the DCQ. As repeatedly explained, Lively's argument ignores the *Contract,* which limits Valero's payment obligation to payment for a quantity of gas that Lively can legally produce and Valero can legally take.

Nonetheless, based on its same specious reasoning, Lively takes issue only with the testimony by Peat, Marwick, Main, and Company's Herbert Warner ("Warner"), who simply summarized that Valero had taken the DCQ assuming that Valero's takes had equalled its downstream market demand. (D. Ex. 91; S.F. 1406-07.) This assumption was supported by Valero's essentially uncontroverted evidence, and thus the jury correctly answered Special Issue No. 2 "no."

The evidence that Valero purchased the DCQ is so overwhelming and unchallenged as to prove Valero's compliance with the Contract as a matter of law. There is *certainly* sufficient evidence, therefore, to compel this Court to overrule Lively's "no evidence" points of error.

(d) *Evidence of Force Majeure Supported the Jury's Answer to Special Issue No. 2.*

The jury's answer to Special Issue No. 2 is additionally supported by evidence of *force majeure* conditions excusing Valero's performance under the Contract. As set forth in § IIIB, *supra,* the Contract's *force majeure* clause provides that a party's obligations are suspended by *force majeure* events including "temporary failure of wells or sources of supply of gas, or markets" and "any other causes, whether of the kind herein enumerated or otherwise, not reasonably within the control of the party claiming suspension in which by the exercise of due diligence such party is unable, wholly or in part, to prevent or overcome . . . ." (P. Ex. 1, pp. 26-26A, art. XII, §§ 12.2.) The evidence in the Record is not only ample but in fact uncontroverted that Valero's markets have failed miserably, a *force majeure* condition as defined by the Contract. (Id.; S.F. 573; *see* § VIII (B)(1)(b) herein.) Moreover, no one contends that this failure of markets was reasonably within Valero's control, that it could have been prevented by Valero, or that it was foreseeable. Therefore, the jury had ample basis to answer Special Issue No. 2 "no" on the basis of *force majeure* alone. (S.F. 536, 593-94; *see Kodiak,* discussed in § IVB(2), *supra.*)

2. *Lively's Own "Evidence" On "Deliverability" Was So Discredited That It Warranted the Jury's Rejection.*

At trial, Lively's sole method for attempting to prove its case was through evidence of "deliverability tests" allegedly conducted on the wells at issue. Ignoring the Contract's definition limiting "Deliverability" to maximum production under *Commission rules and regulations,* Lively contended that "G-10" tests demonstrated Deliverability. G-10 tests are mechanical tests that measure the flow of gas over a twenty-four hour period after a forty-eight hour pre-flow. (S.F. 227-228.) The results are recorded on verified "G-10" forms filed with the Commission. (S.F. 972-973, 977.) The tests are designed to help the Commission determine how much gas a well is capable of producing under normal operating conditions. (S.F. 814, 822.) Lively claimed that by failing to take-or-pay for 90% of the volumes reflected on the G-10 tests, Valero failed to take the DCQ.

Even accepting *arguendo* Lively's erroneous assumption that "Deliverability" under the Contract is strictly based on G-10 volumes, with no limitations pursuant to the Gas Market Demand Rule, Lively failed to prove its case "by a preponderance of the credible evidence," because its evidence was devoid of believability.

Lively's purported "expert" on damages, Max Powell ("Powell"), admitted that if Lively's reported G-10 volumes were wrong, *all of Lively's calculations were wrong.* (S.F. 442.) It became crystal clear at trial, even through Lively's own witnesses, that the volumes Lively reported on its G-10 forms had no basis in reality.

(a) *The Requisites of a True G-10 Test.*

The Commission has established certain mandatory guidelines for conducting G-10 tests. Lively's own witness Jimmy Condra ("Condra"), president of the company that services Lively's wells, testified that a valid G-10 test entails: (i) *pre-flow* of the well for 48 hours before the twenty-four hour "G-10" test; (ii) an additional determination that the flow has in fact *stabilized* during the pre-flow and before the actual test; and (iii) the presence of normal operating conditions. (S.F. 227-28, 253-55, 277.) Moreover, the volumes reported from the twenty-four test period cannot exceed 75% of the average of the 48 hour pre-flow volumes. (*Id.*)

The 48-hour pre-flow and stabilization requirements are essential to the validity of the tests since, as Condra admitted, the Lively wells "spurt" or peak in production when they are "opened up" after a period of no production, and require time to taper into normal production. (S.F. 274-76, 952.) Condra conceded that *a G-10 test run on a "spurt" day is not a "true" G-10 test.* (S.F. 277.)

(b) *Lively Did Not Prove that "True" G-10 Tests Were Ever Conducted.*

Condra swore to so many different stories about conducting G-10 tests that the jury could easily have decided *no* G-10 tests were ever conducted. First, he took two inconsistent positions in his deposition testimony which was read to the jury. He admitted that he had not conducted a G-10 test for five years. (S.F. 600-661.) However, he also claimed in deposition that his pumpers Mallie Turner ("Turner") or Foy Strickland *had* performed G-10 tests on the wells since 1984, and that Turner had been responsible for the Lively wells for a significant period of time before that. (S.F. 660-62.)

Turner in *his* deposition flatly contradicted Condra and testified that he *had never run a G-10 test* and did not know who, if anyone, ran G-10 tests in Condra's organization. (S.F. 952-53, 955.) Condra then changed his story again for trial. On direct examination he testified he used meter charts fresh off the wells' production meters to prepare the G-10 forms. (S.F. 228-29, 233.)

Condra's testimony not only conflicted with that of his own employee, it was internally inconsistent: he testified on direct that he notified Valero and the Commission of the date of the G-10 test. (S.F. 240, 271.)

On cross-examination, Condra revised his testimony yet again and conceded that he never really "tested" the Lively wells on a particular day, but rather gathered G-10 data from the meter charts *sometime* during a three month period. (S.F. 271-74.)

The internal inconsistencies in Condra's testimony rendered it so doubtful that the jury would have been justified in rejecting it on that basis alone.

(c) *Even Assuming Condra Conducted G-10 Tests, They Were Not Conducted in Accordance With Commission Requirements.*

Even assuming *arguendo* the truth of Condra's latest sworn contention that he used meter charts to conduct G-10 tests (S.F. 232), his reported "results" were invalid. (D. Ex. 27.) As Condra admitted, Lively's production log volumes should track reported G-10 volumes. (S.F. 663.) The evidence showed, however, that he often recorded numbers on the G-10 forms that bore no relation to corresponding numbers on Lively's production logs. (D. Ex. 27, S.F. 740-883.) Moreover, Lively's own production logs, Charts Inc. Statements (production statements prepared by "reading" Lively's meter charts), and production reports filed with the Commission on Form P-2 proved that Lively's recorded G-10 volumes were invalid under Commission requirements. (D. Ex. 27; S.F. 740-883.)

Parish gathered relevant information produced by Lively in discovery, including Lively's actual daily production logs, Charts Inc. Statements, and Commission Form P-2 production reports, inputted it into a computer, and prepared graphs showing the *actual* production per day for particular wells during months in which Lively reported that a G-10 test was conducted. (S.F. 740-42, 753, 802-03; D. Ex. 27.) Parish's graphs revealed that: (i) *many of Lively's G-10 reports referenced fabricated "tests" conducted during months in which there was no production from the wells;* (ii) many of the reported volumes were from "spurt" days with *no* pre-flow, inflating the volumes; and (iii) many of the reported volumes exceeded 75% of the average of 48-hour pre-flow volumes. (D. Ex. 27; 442, 805-28.) To cite just one of many examples, Lively's production reports showed that Aldwell Ranch Well No. 22-8 did not produce *at all* during May 1983. Nonetheless, Lively disingenuously reported "results" of a G-10 test on this well during May of 1983 and, even more baldly, concocted a 25% increase in its reported production from the last G-10 test. (S.F. 812-13; D. Ex. 27.)

(d) *Other Evidence Demonstrated the G-10s' Invalidity.*

Travis Crow, Director of Reserve Evaluation at Valero, analyzed the wells' historical performance and Lively's studies of the wells' reserves, and determined that Lively's reported G-10 volumes were approximately *double* the true physical ability of the wells to produce. (D. Ex. 56, 57, 58; S.F. 1191-1300.) Moreover, Herbert Warner compared Lively's reported G-10 volumes with Lively's *actual production* on days Valero was legally able to take —and was purchasing—all the gas Lively could physically produce, and found that Lively's *actual deliveries* were only 76% of its reported G-10 volumes. (S.F. 1414, 1425-26.)

It is the jury's *exclusive* province to weigh the credibility of the witnesses and determine the weight to be accorded their testimony. Based on the extensive evidence undermining Lively's G-10s even from its own witnesses, the jury understandably could have decided that Lively concocted G-10 tests instead of conducting them, or at least failed to prove any damages with reasonable certainty, and thus that Lively did not prove its case even under its own faulty assumptions.

X. LIVELY'S ERRONEOUS PREEMPTION ARGUMENT

Reply Points of Error 12-13 In Summary:

THE COURT OF APPEALS' HOLDING THAT THE CONTRACT LIMITS VALERO'S PAYMENT OBLIGATION TO THE AMOUNT THAT CAN BE LEGALLY PRODUCED DOES NOT RENDER THE GAS MARKET DEMAND RULE EITHER PREEMPTED BY THE NATURAL GAS POLICY ACT OR VIOLATIVE OF THE COMMERCE CLAUSE.

In its Application, Lively makes two arguments it alleged for the first time in its Motion for Rehearing: that the Gas Market Demand Rule is preempted by the Natural Gas Policy Act, and that it violates the Commerce Clause.

First, in its Appellant's Brief and Reply Brief Lively never controverted the validity of the Gas Market Demand Rule *per se*, or the Commission's jurisdiction over Lively and Valero. It cannot raise these points of error for the first time in a motion for rehearing. *See Gillen v. Diadrill,* *Inc.*, 624 S.W.2d 259, 264 (Tex. App.—Corpus Christi 1981, writ dism'd).

Moreover, its argument is again a red herring because it is based on the same flawed contention that the court of appeals held that the Gas Market Demand Rule unilaterally abrogated contract rights. It did not; the court found that the parties *agreed* that the payment obligation was limited to legal deliverability.

Neither *Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board of Mississippi,* 106 S. Ct. 709 (1986), nor *McGoldrick Oil Co. v. United Gas Pipe Line Co.*, C.A. No. H-84-4971 (September 17, 1987), are applicable. In *Transco,* which did not involve the interpretation of a take-or-pay provision, the Court discussed the application of a Mississippi state ratable take order to an *interstate* pipeline, not an intrastate pipeline like Valero. In holding the ratable take order preempted for interstate pipelines, the Court noted in part that Transco's compliance with Mississippi's law "disturbs the uniformity of the *federal* scheme, since *interstate* pipelines would be forced to comply with *varied* state regulations of their purchasing practices." 106 S. Ct. at 712. *Transco* does not apply here, where the purchaser is an *intrastate* pipeline, and where the parties *agreed* to limit payment obligations to a quantity that can be produced under Commission regulations.

Moreover, the order in *McGoldrick* is also inapposite. First, defendant United Gas is again an interstate pipeline. Also, the *McGoldrick* court noted that "the Texas rule is relied on by United solely to free itself of a contractual obligation. . . ." Valero, however, is not relying on the Gas Market Demand Rule to unilaterally *free*

Valero of a contractual obligation. Rather, in this case the Contract does not *impose* on Valero any obligation to pay for gas it cannot legally take.[8]

CONCLUSION AND PRAYER

The Record and Texas law demonstrate conclusively that Lively's Application should be denied.

WHEREFORE, Valero prays that the Application be denied, or alternatively that the court of appeals' judgment be affirmed, and that Valero recover its costs of court in this appeal and such other relief to which it may be justly entitled.

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[8] Lively's assertion that the interstate/intrastate distinction is irrelevant is also wrong, even though it need not be considered since the cited cases are factually not on point. Lively would welcome the interference of the Federal Energy Regulatory Commission in strictly intrastate dealings, when even the federal courts themselves have not gone this far. The logical extension of Lively's argument is that the Texas Railroad Commission, and the Texas Statutes on conservation, are all entirely preempted by the federal regulatory scheme. It is not surprising that none of the cases Lively cites support this proposition.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Respondent's Reply to Application for Writ of Error has been served on opposing counsel by certified mail, return receipt requested, on the 27th day of July, 1988.

/s/ CARRIN F. PATMAN
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NO. 04-87-00380-CV

IN THE COURT OF APPEALS
FOURTH SUPREME JUDICIAL DISTRICT
OF TEXAS AT SAN ANTONIO

LIVELY EXPLORATION COMPANY, ET AL.,
Appellants,

vs.

VALERO TRANSMISSION COMPANY,
Appellee.

ON APPEAL FROM THE
DISTRICT COURT OF SUTTON COUNTY
112TH DISTRICT COURT OF TEXAS

BRIEF OF AMICII CURIAE IN SUPPORT OF APPELLANTS' RESPONSE POINT ONE

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PAGE RELEVANT TO MOTION TO DISMISS:

III.

AN INCORRECT HOLDING THAT THE TEXAS CONSERVATION AND PRORATIONING STATUTES AND REGULATIONS INTERFERE WITH TAKE-OR-PAY OBLIGATIONS WILL RESULT IN PRE-EMPTION OF THOSE STATUTES AND REGULATIONS BY FEDERAL LAW.

In ~~*Transco*~~ (discussed previously at page 6 of this Brief), the United States Supreme Court recognized that take-or-pay provisions in gas purchase contracts are not abrogated or modified by State proration and ratable-take regulations. To the contrary, such take-or-pay contract provisions take priority over state regulations.[15] The Supreme Court expressly recognized the validity of take-or-pay provisions and, in pre-empting the ratable-take orders of Mississippi, reasoned that forcing the pipeline company to purchase gas from producers other than those with whom it had fixed purchase requirements would expose it to liability from those contracted producers under take-or-pay clauses. The result would be that those additional costs would be passed through to consumers. The Supreme Court concluded that the Mississippi ratable-take regulations interfered with the

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[15] While no authority has been found that applies the holding of *Transco* to intrastate pipelines, that application would be logical. Since the Natural Gas Policy Act, 15 U.S.C. Sec. 3310 *et seq.*, regulates first sales of gas, regardless whether destined for interstate or intrastate markets, pre-emption by that federal statute would probably apply as well to purchases by intrastate pipeline companies. Moreover, from a practical standpoint, it seems impossible to limit the effects of the holding in *Transco* only to interstate pipeline companies. It is simply not feasible for the Railroad Commission to promulgate and enforce separate ratable-take systems for interstate and intrastate pipeline companies which would be equitable and in furtherance of the State conservation and proration laws.